

## **Free trade, public goods and regime theory**

a theoretical discussion of the links between trade theory and IR-theory

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# **Free Trade, Public Goods, and Regime Theory:**

A theoretical discussion of the links  
between trade and IR-theory

By:  
Ole Kirkelund

**WORKING PAPER**

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## Abstract

This working paper provides a theoretical discussion of the linkages between international trade theory and international relations (IR-) theory concerning international trade liberalisation. IR-theory on international co-operation is generally labelled "regime theory". Regime theory aims at explaining the different political "driving forces" behind international co-operation concerning global and regional public goods (e.g. environmental protection). International trade liberalisation is typically seen as a public good since it yields both global and national economic benefits for all trading countries according to David Ricardo's classic trade theory. International agreements (i.e. international regimes) such as the General Agreements on Tariffs and Trade (GATT) and international organisations such as the World Trade Organisation (WTO) have therefore been at the centre of regime theory.

However, regime theories concerning international co-operation on securing global interests in free trade seem to be more or less divorced from discussions on the nature of free trade as a public good. That is to say, the logic of game theory and political economy approaches, which are often employed in these analyses seem to be somewhat inconsistent with pure "Ricardian" trade theory or even the neo-classic version of Heckscher-Ohlin-Samuelson. If one furthermore considers the propositions of new trade theories stressing imperfect competition, increasing returns to scale, and strategic trade policies it is necessary to take a critical look at the nature of free trade as a public good. The propositions of classic trade theory, main stream regime theories are insufficient for analysing the politics of the international trade regime. In particular, the rationalistic propositions of main stream neo-liberal and neo-realist perspectives on international co-operation are problematic.

The gap between new insights of modern trade theory and IR-theory on international trade liberalisation may give way for alternative or supplementary explanations on how the WTO regime works. Here cognitive or "reflectivist" IR-perspectives on international regimes will be considered. These perspectives stress the significance of factors such as ideology and moral values.

The discussion unfolded here constitutes an important theoretical component of a forthcoming Ph.D. dissertation by the author of this paper (Working title, "*Free Trade, Public Goods, and Regime Theory: Lessons from WTO trade-environment disputes*"). The main body of the present paper will appear again in my dissertation where it will serve as a theoretical point of departure for analysing concrete dispute settlements in the WTO. This provisional publication is intended to stimulate the debate on the relationship between regime theory and trade theory and facilitate feedback on my current work concerning the WTO regime.

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## Free Trade, Public Goods, and Regime Theory: A theoretical discussion of the links between trade theory and IR-theory

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## **Abstract**

This working paper provides a theoretical discussion of the linkages between international trade theory and international relations (IR-) theory concerning international trade liberalisation. IR-theory on international co-operation is generally labelled “regime theory”. Regime theory aims at explaining the different political “driving forces” behind international co-operation concerning global and regional public goods (e.g. environmental protection). International trade liberalisation is typically seen as a public good since it yields both global and national economic benefits for all trading countries according to David Ricardo’s classic trade theory. International agreements (i.e. international regimes) such as the General Agreements on Tariffs and Trade (GATT) and international organisations such as the World Trade Organisation (WTO) have therefore been at the centre of regime theory.

However, regime theories concerning international co-operation on securing global interests in free trade seem to be more or less divorced from discussions on the nature of free trade as a public good. That is to say, the logic of game theory and political economy approaches, which are often employed in these analyses seem to be somewhat inconsistent with pure “Ricardian” trade theory or even the neo-classic version of Heckscher-Ohlin-Samuelson. If one furthermore considers the propositions of new trade theories stressing imperfect competition, increasing returns to scale, and strategic trade policies it is necessary to take a critical look at the nature of free trade as a public good. The propositions of classic trade theory, main stream regime theories are insufficient for analysing the politics of the international trade regime. In particular, the rationalistic propositions of main stream neo-liberal and neo-realist perspectives on international co-operation are problematic.

The gap between new insights of modern trade theory and IR-theory on international trade liberalisation may give way for alternative or supplementary explanations on how the WTO regime works. Here cognitive or “reflectivist” IR-perspectives on international regimes will be considered. These perspectives stress the significance of factors such as ideology and moral values.

The discussion unfolded here constitutes an important theoretical component of a forthcoming Ph.D. dissertation by the author of this paper (Working title, “*Free Trade, Public Goods, and Regime Theory: Lessons from WTO trade-environment disputes*”). The main body of the present paper will appear again in my dissertation where it will serve as a theoretical point of departure for analysing concrete dispute settlements in the WTO. This provisional publication is intended to stimulate the debate on the relationship between regime theory and trade theory and facilitate feedback on my current work concerning the WTO regime.

## ***Introduction***

For decades (or at least since the end of World War 2) free trade has been regarded as an indisputable collective interest of the international society. The basic propositions of David Ricardo that every nation would gain from free trade and international division of labour have been celebrated as an undeniable truth of international economics. Yet, the experience of international politics on trade has not been a steady decline of trade barriers. Instead, the climate of international trade has been changing between harsh protectionism and mutual dismantling of trade barriers ever since the days of Ricardo. (The post war experience generally being one of trade liberalisation).

International political economy and international relations theory (IR-theory) have offered different explanations as to why the conclusions of international economic theory have not readily been translated into rational international politics. The main stream positions of IR-theory have either been very optimistic about the realisation of the benefits of international trade through trade liberalisation, or, they have been rather pessimistic. Neo-liberal IR-theory tends to predict co-operative outcomes of international trade politics, and neo-realist perspectives tend to predict non-co-operative outcomes. Thus, each of the main stream, IR-perspectives on international trade seem to have a problem of providing a rational basis for explaining both kinds of outcomes.

In this study I argue that neo-liberal perspectives on international trade liberalisation are optimistic for the wrong reasons and that neo-realists, on the other hand, are too pessimistic failing to explain the (apart from the Seattle breakdown) quite co-operative outcomes of the present WTO trade regime. Based on a theoretical discussion of main stream IR-theories on international co-operation and of international trade theory I argue that a third (complementary) perspective that is less dependent on rationalistic assumptions is called for. I further argue; that recent experiences on the settlement of so-called “trade-environment disputes” under the WTO regime show that a cognitive perspective may constitute such a complementary perspective on international trade liberalisation.

The liberalisation of international trade in the post war period has been a major feature of studies within the field of IR-theory. Some theorists understand the world system as being increasingly interdependent or “globalised”. The scope and significance of economic transactions and interactions has increased the scope of common interests and the need for co-operation. The interdependent nature of international relations and the risk of uncoordinated behaviour resulting in Pareto-sub-optimal outcomes have been a major concern of the neo-liberal school of IR-theory. Although the global and interdependent nature of the international polity is not unprecedented<sup>1</sup> the theoretical debate over the importance of absolute gains (thus avoiding sub-optimality) as opposed to relative gains and power struggles is primarily a characteristic of the so-called “neo-neo” debate between neo-liberal and neo-realist schools of IR-theory<sup>2</sup>. This debate between neo-realists

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<sup>1</sup> Paul Hirst & Grahame Thompson, *Globalization in Question*. Polity Press, Cambridge 1996.

<sup>2</sup> Norman Angell's "The Great Illusion" might be a notable exception to this constituting an early statement of international interdependence. Pre World War 1. international relations were indeed characterised by substantial international trade and economic interdependence and Angell

and neo-liberals has become stronger during the last 20 years and it has long been tipping in favour of the neo-liberals, although it is far from settled. A clear indication of this is the development of interdependence theory<sup>3</sup> and of regime theory<sup>4</sup> the latter of which focuses on international institutions (such as the WTO) and various kinds of international agreements.

The reason why international regimes/institutions<sup>5</sup> are important is that they can facilitate the provision of public goods. As such the potential gain from international co-operation and co-ordinated behaviour is in itself a public good (i.e. a collective interest) of the co-operating states or “world society” as some scholars of international politics would have it<sup>6</sup>. The nature of international public goods effectively prohibits their provision by the individual rational behaviour of single states. Moreover, due to the anarchical nature of world society a central authority capable of constraining the individual rational behaviour of single states in the common interest of all states is lacking, and optimally co-ordinated behaviour is unlikely to occur as a spontaneous order<sup>7</sup>. Therefore some other mechanism of constraining and co-ordinating the behaviour of states is required.

International agreements (e.g. the GATT, CITES, LRTAP, the Montreal Protocol, the Basel Convention, UNCLOS, and the Antarctic Treaty Regime) and international organisations (e.g. the WTO, IMF, the World Bank, IMO, and the various UN organisations) constitute alternative mechanisms to central authorities by creating “sets of implicit or explicit principles, norms, rules and decision-making procedures around which actors expectations converge in a given issue area of international relations”<sup>8</sup>. Together these agreements and organisations are labelled “international regimes” which supposedly enable individual states to co-ordinate behaviour and forego individual (relative) gains. This maximises both collective and individual (absolute) gains in the common interest of all states or a group of states. The co-ordination of national trade policies and the establishment

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emphasised the folly of warfare under these circumstances (the idea of gaining from war being the great illusion). Unfortunately shortly after the book was published war broke out and Angell later became the favourite victim of realist ridicule.

<sup>3</sup> Robert O. Keohane and Joseph S. Nye, *Power and Interdependence: World Politics in Transition*. Little Brown, Boston 1977.

<sup>4</sup> Stephen D. Krasner (ed.), *International Regimes*. Cornell University Press, Ithaca 1983; Oran R. Young, *International Cooperation: Building Regimes for Natural Resources and the Environment*. Cornell University Press, Ithaca 1989; *International Governance: Protecting the Environment in a Stateless Society*. Cornell University Press, Ithaca 1994; Volker Rittberger (ed.), *Regime Theory and International Relations*. Clarendon Press, Oxford 1995; Andreas Hasenclever, Peter Mayer and Volker Rittberger, *Theories of International Regimes*. Cambridge University Press, Cambridge 1997.

<sup>5</sup> As noted by Hasenclever, Mayer and Rittberger (1997) op. cit., p. 1, international regimes can be seen as a special case of international institutions. I shall use the terms interchangeably though primarily applying the term “regime” when referring more generally to order and co-operation within some issue-area of international politics. Thus, the term “institution” may be used when referring to specific characteristics of a regime such as decision making procedures, rules, and organisational setup. The WTO-system may be seen as an institutional system constituting an international regime in the field of trade although generally, the terms “Regime” and “institution” more or less carry the same meaning.

<sup>6</sup> E.g. Hedley Bull, *The Anarchical Society: A Study of Order in World Politics*. London 1977

<sup>7</sup> For a discussion on spontaneous orders, rationality and markets see Robert Sugden, “Spontaneous Order”, *Journal of Economic Perspectives*. Vol. 3, no. 4, Fall 1989, pp. 85-97. Sugden ascribes the concept of “spontaneous order” to Friedrich Hayek, *The Constitution of Liberty*.

Routledge and Kegan Paul, London 1960. Young also has some comments on this using the term “spontaneous arrangements”. See Oran R. Young (1989) op. cit., pp. 84-86.

<sup>8</sup> Krasner (1983) op. cit. p. 2.

of an international code of conduct concerning trade are some of international society's collective interests. The GATT / WTO regime is seen as the mechanism which secures this interest in the face of formal anarchy.

The collective interest in free trade and the need to co-ordinate trade policies is not as straightforward as the need of rules for driving on the right or left side of the road<sup>9</sup>. This metaphor was in fact used by Jagdish Bhagwati to illustrate the obvious advantage of co-ordinating international trade policies:

*"The notion that international organizations such as the WTO inevitably involve the surrender of sovereignty in everyone's common interest, the way that we accept the curtailment of the right to drive anywhere on the road and must drive only on the left or the right, seems somehow to get lost in these attacks on the WTO"*<sup>10</sup>.

However, this begs the question of why the politics of international trade has been so marked by conflicts since the very first GATT negotiations. If you take Bhagwati's metaphor at face value a perfect free trade regime could (in principle) be expected to function with a minimum of means to ensure compliance<sup>11</sup>.

The need for explanation could be illustrated with a joke that the Danes like to tell about their Swedish neighbours. When the Swedes in the late 1960's changed their traffic regulations from driving on the left to driving on the right, the Danes suggested that the Swedes started by changing the rules for trucks only in order to have a smooth and gradual change to the new situation!

Perhaps this tells us something about the bureaucratic incrementalism that characterises the Swedish (and Nordic) political culture, but it also tells us something about the needlessness of devoting large scale police resources to enforce compliance - at least regarding some traffic regulations. Once regulations for driving have been established virtually no incentives for non-compliance exist (other than suicide perhaps) and it is doubtful that any regulation is at all needed. After some initial accidents, driving on the correct side of the road would probably emerge as a spontaneous order<sup>12</sup>. This is clearly not the case with the WTO-rules. Instead, the usual dilemmas of collective action (i.e. prisoners and free-rider dilemmas) can be expected to prevail when co-operation in the field of international trade is to be established. This is not because of actors failing to recognise the benefits of free trade, but because of the very nature of these benefits.

I shall argue, however, that although the co-ordination of trade policies provided by the WTO is in itself a public good for the members of the trade regime, the benefits of free trade (e.g. economic growth) might not be so in the classical sense of the word. There might still be dilemmas concerning collective action involved in establishing a free trade regime, but the collective interest in such a regime is in need of further explanation. This is especially so if certain modifications of pure "Ricardian" trade theory are considered.

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<sup>9</sup> Stephen D. Krasner describes this as a "simple co-ordination problem" in "Global Communications and National Power: Life on the Pareto Frontier". *World Politics*, 43, pp. 336-66.

<sup>10</sup> Jagdish Bhagwati, *The Feuds over Free Trade*. Institute of South East Asian Studies, Singapore 1997, pp. 13-14.

<sup>11</sup> This is my own conclusion. Bhagwati does not make such a claim himself.

<sup>12</sup> Central regulation would of course diminish the amount of initial accidents thereby decreasing the transaction costs of establishing a new order.



Paul R. Krugman has pointed to what he calls “a new breed of models” of international trade theory which emphasise the importance of increasing returns and imperfect competition as opposed to the classic constant returns, perfect competition models<sup>13</sup>. Although these models do not question the global allocative gains of free trade they do, however, question not only the notion of comparative advantage as the basis for free trade, but also the notion of free trade as an advantage for any single state.

As emphasised by Robert Constanza (et.al.) the economic and allocative gains associated with free trade (based on the notion of comparative advantage) depend on at least five crucial assumptions<sup>14</sup>:

- First, externalities such as pollution should be absent or completely “internalised” (by way of taxes or administrative regulation). If not, specialisation may result in sub-optimal allocation and a country may find itself engaged in activities that actually lower its welfare.
- Second, prices should be stable and unaffected by market effects of expanding production. In other words, increased production should not lower prices which in turn are exclusively determined by production costs regardless of demand. In the real world expanded production would typically lower prices significantly.
- Third, comparative advantages should be constant over time. However, in fact a country might be better off attempting to enter other markets than the ones in which it currently holds a comparative advantage. Implementing strategic trade policies that spur technological innovation is often a better strategy than sticking to comparative advantages.
- Fourth, there should be no coercion in production or exchange. This occurs when market imperfections in the form of monopolies and oligopolies prevent weaker parties from sharing the benefits of trade. This is often the case on both international and domestic markets. Markets with only little or no competition may constitute another incitement for implementing strategic trade policies since monopolies yield excess profits.
- Fifth, there should be no international mobility of capital. If capital moves freely over borders absolute advantages will determine the conditions of international trade instead of comparative advantages.

All these critical assumptions influence on both the national and the global gains associated with free trade. Especially international mobility of capital interferes with the notion of comparative advantages on which most other assumptions concerning the gains of free trade are based. The critical assumptions mentioned by Constanza and those of strategic trade theory mentioned by Krugman influence on the political economy game of international trade liberalisation.

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<sup>13</sup> Paul R. Krugman, “Is Free Trade Passé?”. *Journal of Economic Perspectives*. Vol. 1, no. 2, Fall 1987.

<sup>14</sup> Robert Constanza (et.al.), “Sustainable Trade: A New Paradigm for World Welfare” in Robert Constanza, *Frontiers in Ecological Economics*. Edward Elgar, Cheltenham 1997, pp. 473-485.

I shall emphasise the importance of international capital mobility since this constitutes absolute advantages as the basis for trade rather than comparative advantages. In turn it prohibits the creation of a free trade regime as a spontaneous order (or possibly even a negotiated order<sup>15</sup>) solely based on the rational action of individual states. A spontaneous order could in fact occur had the assumption of comparative advantage been correct. The fact that no such order has appeared suggests otherwise.

The implications on IR-theory and regime theory of the other critical assumptions mentioned above should not be ignored. I shall emphasise the importance of international mobility of capital since this is a central aspect of classic trade theory and may affect a number of other assumptions concerning the effects of free trade. Furthermore, the assumption of comparative advantage seems to have been uncritically imported by main stream IR-theory and regime theory on international trade liberalisation. However, both capital mobility, strategic trade policies, as well as internalisation / externalisation of environmental costs of production (i.e. environmental regulations) affect the individual (national) gains associated with free trade and in turn the support of the WTO regime by the individual members.

The nature of free trade as a global interest and the associated dilemmas of collective action also affect the choice of theoretical and analytical perspectives that should be employed for analysing the politics of the international trade regime. IR theories concerning international co-operation (i.e. regime theories) are all concerned with the central question of how to overcome the dilemmas of collective action; to constrain the behaviour of individual states pursuing national interests; and to achieve co-operation in the common interest of all states or a group of states. However, the dilemmas of collective action concerning the establishment of a global free trade regime (i.e. the incentives for protectionism) depend more or less on the individual gains associated with a co-operative free trade strategy. I shall argue that international capital mobility plays an important role in deciding whether there is always an absolute gain for any individual state participating in a free trade regime, or, whether this only pertains to the trading nations collectively. Thus, individual national gains depend, among other things, on national differences in productivity, the strategic gains and competitive advantages associated with a general removal of trade barriers, and on the likelihood of winners compensating losers. Compensation leaving both winners and losers with a net gain is theoretically possible since total gains will exceed total losses.

In conclusion, certain modifications of pure Ricardian trade theory (and even of the neo-classic versions) are relevant in order to obtain a more realistic picture of the political economy of international trade liberalisation. The status of free trade as a collective good is questionable. This in turn also challenges some of the key assumptions of regime theory employed in the analysis of the international trade regime (i.e. GATT / WTO). As such the very existence of the WTO, the political outcomes of the Uruguay round, and the widespread international celebration of free trade (in spite of protectionist violations of GATT-agreements) calls for alternative explanations of the dynamics of the trade regime. Cognitive or constructivist variants of regime theory might offer such alternative explanations of international co-operation for the reduction of trade barriers.

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<sup>15</sup> Young uses the term "negotiated arrangements". See Young (1989) op. cit., p.86.

## **Free Trade and Public Goods**

### **Introduction**

Within international political economy and international relations theory (IR-theory) free trade is normally regarded as a so-called public good. The international community (society) has a common interest in realising the benefits of trade and free movement of goods and services, which in turn requires co-operation. The status of free trade as a public good, however, makes co-operation among sovereign (independent) rational actors in an anarchical international society difficult or unlikely. In the absence of central authorities some other mechanism to secure co-ordination / co-operation is required. International agreements such as the GATT-agreements and international organisations such as the WTO (i.e. international regimes) constitute such alternative mechanisms. The point is, however, that the need for international regimes or co-ordinating mechanisms is not entirely self-evident as seen from the point of view of classic theory of international trade. The benefits of free trade differ on several accounts from traditional public goods. If you take certain modifications of classic trade theory into consideration the notion of free trade becomes even more problematic.

The status of free trade as a public good serves as a point of departure for especially neo-liberal analyses of and regime theory on international co-operation concerning trade liberalisation. Furthermore, it is the existence of dilemmas of collective action pertaining to the provisions of public goods which serves as a basis for theoretical discussions on the importance of international agreements and organisations (i.e. international regimes) for establishing co-operation. The so-called “Prisoners Dilemma” and the “Free Rider Dilemma” are the central dilemmas facing individual rational actors needing to co-operate in the pursuit of common interests in public goods. International co-operation on trade liberalisation and the elimination of barriers to trade are regarded as classical examples of public goods associated with a prisoners dilemma<sup>16</sup>. In an international political system of individually rational actors (states) and no central authority capable of enforcing co-operation or providing the public good unilaterally international regimes such as the WTO are believed to be important.

It is evident that international trade requires that the single states co-operate in order to dismantle trade barriers. It is ipso facto the single states who decide the scope of regulations that can constitute trade barriers. It is, however, less evident why a removal of those barriers is associated with dilemmas of collective action. Why don't they just co-operate in the common interest of all?

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<sup>16</sup> An example from the tradition of collective action theory is Robert Axelrod, *The Evolution of Cooperation*. Basic Books, New York 1984, p. 7; and from the tradition of international political economy: Bernard M. Hoekman and Michael M. Kosteki, *The Political Economy of the World Trading System: From GATT to WTO*. Oxford University Press, Oxford 1995.; Robert E. Baldwin, "The Political Economy of Trade Policy. *Journal of Economic Perspectives*. Vol. 3, no. 4, Fall 1989, pp.119-135; John A. C. Conybeare, "Public Goods, Prisoners Dilemmas and the International Political Economy". *International Studies Quarterly*. (1984), 28, pp. 5-22.

In the following, I will discuss the defining characteristics of public goods affecting the possibility of co-operation among individually rational actors. Note that I do not thereby make a claim that states are in fact rational unitary actors. Rather, this should be seen a point of departure or a critical assumption allowing us to construct and discuss initial propositions about how an international trade regime might come about. Second, in the next section, I will discuss how and if these defining characteristics of public goods can be said to apply to free trade.

## Public goods

Public goods (or “collective goods”) are said to have two defining characteristics: “indivisibility” and “non-excludability”. These two characteristics can be present to a variable degree and impede the sufficient provision of the good in question<sup>17</sup>.

A good can be said to exhibit indivisibility (or “jointness of supply”) if it, once produced, any given unit can be made available to everybody (or a group of individuals), or if the consumption of the good by any individual does not diminish the amount available to others<sup>18</sup>. Thus indivisibility means that the good cannot be provided partially or in chunks (half a bridge or half a lighthouse is no good). Equally A’s consumption does not detract from B’s possibilities of consumption which means that the good does not disappear while consumed, or in other words it is not used up (at least not in the short run). Taylor emphasises that strictly speaking public goods are not “consumed”. Military defence (i.e. deterrence) and radio broadcasts are not physically consumed. However, Taylor chooses to maintain the expression in order to correspond with the economic literature where the expression is used invariably<sup>19</sup>.

Divisible goods are usually called “private goods” although they need not be in a strictly legal sense. A pie is a perfectly divisible good and the part consumed by A cannot at the same time be consumed by B (or afterwards). The good physically disappears in the process of consumption and the amount available to B is diminished by exactly the amount consumed by A.

A good is non-excludable to the extent that it is impossible exclude anybody (or a member of a group of individuals) from consuming it, or if such an exclusion is prohibitively costly<sup>20</sup>. Lighthouses and clean air are typical examples. It is nonsense to ask people to stop breathing or to stop looking for lighthouses when navigating.

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<sup>17</sup> The terminology used here refers to the standard collective action and rational choice literature. See e.g. Michael Taylor, *The possibility of Cooperation*. Cambridge University Press, Cambridge 1987; Russell Hardin, *Collective Action*. The Johns Hopkins University Press, Baltimore 1982; Mancur Olson, *The Logic of Collective Action*. Harvard University Press, Cambridge Mass. 1965 (reprint 1971). Russell Hardin distinguishes between public goods that are perfectly indivisible and non-excludable and “collective goods” that to some degree are imperfectly indivisible or non-excludable. Hardin (1982) op. cit.. I use the term “public good” irrespectively.

<sup>18</sup> Taylor (1987) op. cit., p. 5-6.

<sup>19</sup> Ibid. p. 186 n.

<sup>20</sup> Ibid. p. 6.

Pure public goods are perfectly indivisible and non-excludable. Apart from lighthouses, military deterrence and social order (i.e. protection from crime) examples of pure public goods are rather few. In most cases, goods are more or less indivisible or non-excludable.

The consumption or use of public goods by one individual often conflicts with the consumption of the good by other individuals although the good is not divisible or physically used up when consumed. This is called “rivalness”. Goods are rival to the extent that the consumption of a unit of the good decreases the benefits to others consuming the same unit. Pure public goods are non-rival. This means that the benefit to one single individual does not depend on the number of individuals sharing the same unit of the good. A public telephone box can only be used by one person at the time and as such it is perfectly rival. Roads can, however, be used by more than one person at the time, but the risk of traffic jams and therefore the individual benefit depends upon how many people are driving on the road at the same time. Light houses are both perfectly indivisible and non-rival and the individual benefit of using the light house does not depend on how many other people are looking at it at the same time (perhaps on the contrary since the risk of other ship ramming into you diminishes).

As such indivisibility and non-rivalness are not the same. The difference between indivisibility and non-rivalness is that the latter pertains to the benefits from using / consuming the good while the former is a characteristic of the good itself, or as Taylor puts it: “.... rivalness, unlike indivisibility, is strictly speaking a property of individuals (or of their utility functions), not of the goods themselves”<sup>21</sup>. The difference is, however, largely theoretical. In practice, it is the availability and therefore the degree of rivalness (rather than divisibility) that is important to the individual. This goes for the case of free trade as well. I shall return to this later.

### Collective action

The reason why the provision of public goods is so problematic is that it entails certain dilemmas of collective action, especially if sufficient provision depends on co-operation between individual rational actors<sup>22</sup>.

In particular, non-excludability is problematic. If it is impossible to prevent someone from consuming a good once provided it pays to take a “free ride” enjoying the good without contributing to the provision of it. The problem of free riders increases with group size and when individual contributions are not critical to the provision of the good. The so-called “free-rider dilemma” is especially present in large groups where individual contributions are relatively unimportant and where they are equally difficult to monitor<sup>23</sup>. Obviously the free-rider dilemma can prohibit the provision of public goods among individually rational actors resulting in

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<sup>21</sup> Ibid., p. 7.

<sup>22</sup> The character of the dilemmas of collective action depends among other things on the type of public good, the number of actors involved, their interest in the good, and the significance of their individual contributions to the provision of the good. Here the dilemmas are only presented in their most basic versions. For an introduction to the different versions of the prisoners dilemma (e.g. N-person prisoners dilemmas) see Taylor (1987) op. cit.

<sup>23</sup> Olson (1965) op. cit.

collective irrational or sub-optimal outcomes. The most likely outcome is that none wishes to contribute to the provision of public goods. Instead, they will head for a free ride waiting for others to contribute.

The so-called Prisoners Dilemma (PD) is the other basic dilemma of collective action. It describes the conditions for co-operation and it shows why the provision of public goods among rational actors can be difficult. The relevance of the PD for the case of free trade pertains to the nature of the benefits associated with international trade (e.g. economic growth and better allocation of resources). The realisation of these benefits depends on mutual co-operation between the trading partners with the aim of dismantling of tariffs and non-tariff barriers to trade.

The metaphor “prisoners dilemma” which is thought to describe the situation of establishing free trade refers to the case of two hard core criminals arrested for a serious crime. Unfortunately, the police cannot convict both of them although they are quite sure that they are both guilty. They need the confession of at least one of them. The two suspects are isolated from each other and they are given the opportunity to confess and witness against each other. The reward is freedom while their accomplice will serve the hardest possible punishment. They face of course the opposite situation if their accomplice confesses first. If both of them confess within a narrow margin of time they will avoid maximum punishment, but they will still serve a very long prison sentence. If none of them confesses, however, the police only have sufficient proof to sentence them for minor offences and they only risk relatively mild punishments.

Assuming actors are individually rational, the dominant strategy will be confession with the rather unfortunate consequence (as seen from the perspective of the suspects) that they will spend a very long time in prison. This is a (Pareto-) sub-optimal result as compared to the one they could have reached had they both refused and pleaded “not guilty”<sup>24</sup>. Confession is the dominant strategy because it yields the best result no matter what their accomplice chooses to do. The possible payoffs from different strategies can be shown with a payoff matrix:

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<sup>24</sup> Both pleading not guilty is the collectively optimal solution. It is also Pareto-optimal since it will not be possible to improve the situation for any one of them without worsening the situation for the other.

Table. 1: Payoff matrix (2-actor Prisoners dilemma).

		PLAYER B	
		C	D
P L A Y E R  A	C	3/3	1/4
	D	4/1	2/2

Defection (D) = confession; Co-operation (C) = denial.

4 = freedom, 3 = mild punishment, 2 = hard punishment, 1 = max. punishment.

The realisation of collective (total) and individual benefits of trade is allegedly dependent on mutual co-operation as described in the PD. Potential trading partners are said to be in the same situation as the convicts mentioned above when they are about to decide whether to remove trade barriers or not. Thus, the PD of international trade is that it is individually rational for any single state to raise trade barriers and protect themselves from international competition independently of what other states choose to do. If country A protects itself behind trade barriers the only rational thing to do for country B is to do the same. If A chooses to open its borders to trade, it is still rational for B to uphold its own barriers allowing it to export its own merchandise while protecting its own industries from foreign competition at the same time. Any single country might be interested in removing trade barriers but only if they can be sure that it will be mutual. No one will be willing to remove trade barriers unilaterally and expose themselves to unfair competition. Braking isolation and allowing for mutual assurance is the central problem of the convicts in the PD game and this is exactly what international institutions as the WTO is thought to accomplish in the field of trade negotiations. By setting up norms, rules and decision-making procedures around which actor expectations converge and allowing for communication isolation is broken. The conditions for co-operation have improved considerably. However, the PD and the problem of mutual assurance is not entirely solved (there is still an incentive to defect).

## Conclusions

It appears that the dilemma rests upon a number of rather strict assumptions. The basic PD game is a “one shot game” and there is only two players whose mutual co-operation is necessary in order to avoid the Pareto-inferior situation and realise the benefits of co-operation. It has been shown that the number of players can change the character of the game substantially and that the associated free-rider

dilemma gets more serious as the number of players increases and the game becomes less transparent for any single player<sup>25</sup>. Hardin and Taylor pointed out that the likelihood of co-operation increases when games are iterated<sup>26</sup>. When games are iterated, conditional co-operation is possible. Hereby predictability and in turn the possibility of positive counter reaction increases. The “Tit for Tat” version of conditional co-operation where initial co-operation is followed by co-operation and defection is followed by defection has proven to be quite a stable solution for the PD<sup>27</sup>.

Regarding the empirical relevance of the dilemmas of collective action, the dynamic elements of the game, the number of players, the possibility for variable contributions and the asymmetries of interests play a crucial role. This goes for the international free trade regime and the co-operation within the framework of WTO institutions as well. The international trade regime consists of many different actors with different interests and possibilities to pursue them. The power of the simple models is, however, that they emphasise the fundamental character of the dilemmas of collective action.

The dilemmas also show that (in spite of changes in the immediate conditions of the game) some mechanism allowing independent rational actors to co-operate is still needed<sup>28</sup>. With the PD as a point of departure, some mechanism capable of breaking isolation and improving knowledge of mutual intentions is needed. In an international system of many different actors a mechanism capable of increasing transparency will increase the possibility for revealing free-riders and thereby the likelihood of successful co-operation.

International institutions like the WTO are supposed to constitute such mechanisms when the benefits of free trade are to be realised. The different versions of regime theory have different propositions as to how and if international regimes help solving the dilemmas of collective action and they offer different interpretations as to the importance of those dilemmas in avoiding the sub-optimal outcomes of mutual defection. I shall return to this discussion below.

Meanwhile it is important to discuss whether it is at all relevant to characterise international free trade as a public good and as a collective interest of the international society. What dilemmas of collective action are in fact involved? To answer the question I will discuss some basic propositions of international trade theory. As mentioned above international mobility of capital, strategic trade policies, and internalisation / externalisation of environmental costs of production (i.e. environmental regulations) affect the terms of trade. These factors influence on the distribution of gains of trade and the character of the dilemmas associated with international co-operation on trade liberalisation.

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<sup>25</sup> The importance of the number of player and group is especially by Olson (1965) op. cit.. See also Taylor (1987) op. cit.

<sup>26</sup> See Hardin (1982) op. cit. and Taylor (1987) op. cit.

<sup>27</sup> Axelrod (1984) op. cit.

<sup>28</sup> John Bayliss and Steve Smith, *The Globalization of World Politics: An introduction to international relations*. Oxford University Press, Oxford 1997, p. 240 emphasises this point. See also Conybeare (1984) op. cit.. Conybeare concludes that PD situations often arise when decisions are to be made concerning goods of collective interest even though the special characteristics of indivisibility and non-excludability are not fully present.



## ***The Case for Free Trade: Global and National interests in trade***

### **Introduction**

In the following, I will examine some the basic notions of classic trade theory. The purpose is to explain why international trade is regarded as something desirable and to identify the character of the benefits of trade according to classic trade theory. What are the benefits exactly and how can they be described as public goods of the international community? Modifications of classic trade theory such as international mobility of capital and strategic trade policy are discussed and the implications of these modifications (vis-a-vis international co-operation on trade liberalisation) are considered.

In many ways, the different strands of economic trade theory also serve as a basis for the political theories of international trade liberalisation. These can in the words of Robert Gilpin be divided into two very different traditions<sup>29</sup>:

First, there is the “Liberal Tradition” which is distinctly pro trade. The liberal tradition is firmly rooted in classic trade theory as represented by Adam Smith and David Ricardo and in the neo-classic versions of Heckscher / Ohlin and Paul Samuelson<sup>30</sup>. Moreover, this tradition corresponds well with neo-liberal versions of IR-theory and regime theory in stressing collective interests, interdependence, and absolute gains of international co-operation on trade liberalisation<sup>31</sup>.

Second, there is the “Nationalist Tradition” which is more sceptical towards the promises of free trade and of the propositions of classic trade theory. Nationalists take a more protectionist position stressing the distributive effects of international free trade. This tradition can be traced back to the “Mercantilists” of the 19<sup>th</sup> century, the “German Historic School”, and new protectionist strands of economic trade theory<sup>32</sup>. Some Marxist theorists can also be included in this tradition and it has its counterparts within the realist / neo-realist and globalist strands of IR-theory<sup>33</sup>. Focus is on dependence, asymmetries of international relations, North-

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<sup>29</sup> Gilpin divides the political theories on international trade into, on the one hand, the “Liberal Tradition” and, on the other hand, the “Nationalist Tradition”. To some extent, he ascribes Marxist theories on international trade to the “Nationalist Tradition”. See Robert Gilpin, *The Political Economy of International Relations*. Princeton University Press, Princeton 1987, p. 172.

<sup>30</sup> Ibid.

<sup>31</sup> For an example of the neo-liberal strand of IR-theory see Robert O. Keohane and Joseph S. Nye Jr., *Power and Interdependence: World Politics in Transition*. Little Brown, Boston 1977 which contributed significantly to the development of regime theory as represented by Stephen D. Krasner (1989 op. cit.).

<sup>32</sup> Gilpin op. cit., p.172. Among the new critics of classic trade theory are Tim Lang and Colin Hines, *The New Protectionism: Protecting the Future Against Free Trade*. Earthscan Publications Ltd., London 1994. See also Herman E. Daly & John B. Cobb Jr., *For the Common Good: Redirecting the Economy Towards the Community, the Environment and a Sustainable Future*. Beacon Press, Boston 1989. Both criticise classic trade theory and advocates a more regional and locally based economy and trade. Neither of them are classic nationalists as envisioned by Gilpin (op. cit., pp. 180-83). They are rather to be seen as “neo-nationalists” with a critical view to international mobility of capital.

<sup>33</sup> The most notable representative of realist IR-theory is perhaps Hans J. Morgenthau, *Politics Among Nations: The Struggle for Power and Peace*. (3<sup>rd</sup> ed.) Alfred A. Knopf, New York 1961

South relations, power struggles, relative gains, security, and national interests as opposed to collective / global interests. However, from the perspective of realist IR-theory the quarrel is not about the gains of free trade as such. Rather, it is about the political prospects of international co-operation on trade liberalisation.

From a normative perspective, there is no question that the liberal tradition has gained the upper hand. The liberal perspective dominates the agenda of the international trade regime as it has developed since the Bretton-Woods<sup>34</sup> agreements in 1944 reaching a temporary climax with GATT94 and the WTO<sup>35</sup>. There seems to be a unique consensus concerning the idea of free trade.

From a theoretical perspective neo-classic trade theory has only been challenged by European and Latin American dependency theorists who during the 1960's and in the first half of the 1970's had some influence via the Economic Commission on Latin America (ECLA) and the United Nations Conference on Trade and Development (UNCTAD)<sup>36</sup>. Apart from the new protectionist critique, opposition to the liberal perspective and to neo-classic trade theory is almost absent today. Even the critique of dependency theorists has vanished under slogans like "Trade not Aid" or in a slightly revised version "More Trade and More Aid". Regardless of which slogan is celebrated, the basic propositions of neo-classic trade theory prevail and under the WTO regime developing countries have even emerged as "pushers" or "frontrunners".

The consensus regarding classic trade theory also pertains to the main opposition to neo-liberal IR-theory and regime theory notably neo-realist IR-theory. The quarrel is not about trade theory. Instead, disagreements concern the importance of relative gains as opposed to absolute gains and assumptions of the behaviour of states. I will discuss the linkages between trade theory and the main perspectives of IR-theory and regime theory in the next section. In the following, I will briefly recapitulate the basic propositions of trade theory. I will also assess some important modifications of classic trade theory (e.g. international mobility of capital) which might have implications for main stream regime theories and which

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(1<sup>st</sup>. ed. 1947), and of the neo-realists: Kenneth Waltz, *Theory of International Politics*. McGraw-Hill, Inc., New York 1979. Globalist views are represented by Immanuel Wallerstein, *The Modern World System I*. Academic Press, New York 1974; *The Modern World System II*. Academic Press, New York 1980. While Wallerstein represents a "system theory variant", "dependence theory variants" are represented by Samir Amin, *Imperialism and Unequal Development*. Monthly Review Press, New York 1977, and André Gunder Frank, *Capitalism and Underdevelopment*. Modern Reader Paperbacks, New York 1969.

<sup>34</sup> Even before the conclusion of World War 2 the allied forces joined at a conference at Bretton-Woods in the USA. The aim of the conference was to establish international institutions for the purpose of co-ordinating the international economy. The conference had two main goals: First, an international system of fixed rates was to be established (however, it was supposed to be adjustable). Second, an international fund of credits capable of relieving national economic crises was to be established. The most important results of the conference was the establishment of the International Monetary Fund (IMF) and the World Bank.

<sup>35</sup> The first GATT agreements were concluded in 1947 and have since been amended by 8 so-called "Rounds" of trade negotiations. GATT94 are the results of the latest of these Rounds notably the "Uruguay Round" (1986-94).

<sup>36</sup> Besides Amin and Gunder Frank (see note 38) other economists of the ECLA and UNCTAD include the Argentine economist Raul Prebisch. For a discussion of these see Paul R. Viotti and Mark V Kauppi, *International Relations Theory: Realism, Pluralism and Globalism*. (2<sup>nd</sup>. ed.) MacMillan Publishing Company, New York 1993, pp. 455-58. Viotti and Kauppi refers to Raul Prebisch, *Towards a Dynamic Development policy for Latin America*. United Nations, New York 1963.

might point to alternative (i.e. cognitive) interpretations of the politics of the international trade regime.

### **Absolute or comparative advantages?** <sup>37</sup>

Adam Smith in his major work “The Wealth of Nations” (1776) was the first to point out the benefits of international trade and international division of labour. By specialising in producing what you do best and importing other goods trading partners would gain both individually and collectively. He was the first to counter the protectionist philosophy of the “Mercantilists” who regarded a positive balance of trade and accumulation of capital (gold and silver) as the main goal of any trade policy.

Gold and silver was at the time the most important means of payment and therefore very important to the national wealth of any single country, and, according to the Mercantilists, it was very important to have a positive balance of trade since only this would increase wealth. A deficit would eliminate any advantage associated with trade. Trade was a part of the international zero-sum game of power and influence, and the wealth of one country meant the poverty of another. “Beggar thy neighbour” was the main strategy of national trade policy. Consequently, any country should aim at importing cheap raw materials and exporting expensive manufactured goods. Imports should be limited by (e.g. by tariff barriers) and export subsidised. In other words from this perspective the situation appears to be Pareto-optimal<sup>38</sup> and at least on the short view only distributive changes are possible.

It is a central assumption of laissez-faire economists like Adam Smith that Pareto-optimality is not at all in effect. It is possible to improve allocation, and international trade is an important step in that direction. Just as a national division of labour will improve efficiency, so will an international division of labour. International trade makes such a division of labour possible thus yielding an absolute gain in welfare both globally and for any single trading country. Although the question of distribution of gains is not automatically solved, the game of international trade politics has changed from a zero-sum game into a positive-sum game.

From the perspective of Adam Smith the idea of an international division of labour was based on absolute advantages (measured by labour productivity). Specialisation was based on single countries concentrating on producing what they did best and importing goods, which could be produced more efficiently elsewhere. Smith believed that free trade would automatically lead to specialisation via

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<sup>37</sup> The presentation of classic trade theory draws particularly on Erik Strøjer Madsen, Jørgen Ulf-Møller Nielsen, Kurt Pedersen, *International Økonomi*. Forlaget Pareto, Århus 1984 and Paul R. Krugman and Maurice Obstfeld, *International Economics: Theory and Policy* (4th. ed.) Addison-Wesley Reading, Mass. 1997.

<sup>38</sup> The term “Pareto-optimality” is named after the Italian economist and sociologist Vilfredo Pareto. Pareto-optimality means that all resources are used (allocated) optimally. Therefore, increasing the utility of one person is only possible while at the same time decreasing the utility of another. Of course the Mercantilists did not believe that all resources were used optimally. However, on the short view economic output could only increase marginally and in practice the distribution of resources was more important as seen from the perspective of any single actor.

competition. The only problem is that trade between two countries is impossible if absolute advantages on all goods reside with one of them.

In “Principles of Political Economy and Taxation” (1817) David Ricardo successfully argued that trade and the associated benefits of allocation and specialisation was not dependent on absolute advantages between trading partners (measured by labour productivity). Trade was also possible based on comparative advantages. Indeed trade is possible even between countries where absolute advantages on all goods rest with one of them if only costs of production are relatively different.

Ricardo proved his point with a simple model of two countries (England and Portugal) producing two different types of goods (wine and cloth). In Ricardo’s model, Portugal had an absolute advantage on both goods, but trade between the two countries is still possible, because relative prices are different. This is illustrated in table 2 below: It follows from this example that Portugal is able to exchange 100 litres of wine into 160 meters of cloth in England as compared to only 100 meters on the home market. Likewise, England is able to exchange 80 meters of cloth into 100 litres of wine in Portugal as compared to only 50 litres on the home market.

Table 2: Production pr. worker / day.

	Cloth	Wine
Portugal	100 m	100 litres
England	80 m	50 litres

In Ricardo’s simple model, transportation costs and differences in real wages are not considered. In a monetary economy (as opposed to barter) advantages would not necessarily be realised immediately. If wages were equal in both countries England would not be able to export and an adjustment would have to take place. This could either be a devaluation of England’s currency or a decrease in wages. (The alternative is of course a revaluation of Portugal’s currency or an increase in wages there).

Even if Ricardo did not include the supply side in his model and assumed constant returns to scale (static comparative advantages) his simple model still serves as the basis for the neo-classic developments of trade theory by amongst others Eli Heckscher and Bertil Ohlin<sup>39</sup>.

While Ricardo exclusively based his theory of trade on differences in labour productivity the so-called Heckscher-Ohlin theory also considers other differences concerning factors of production or “factor endowments” (e.g. land, capital and natural resources). Canada exports wood to the USA not because Canadian lumberjacks are more efficient than their American counterparts (though they may

<sup>39</sup> See Eli Heckscher, ”The Effects of foreign Trade on the Distribution of Income”. *Ekonomisk Tidsskrift*, 1919, and Bertil Ohlin, *Interregional and International Trade*. Harvard University Press, 1935.

well be so). Instead, trade is based on the fact that Canada has much more wood per inhabitant than the more densely populated USA<sup>40</sup>. The fact that goods are produced with different factor intensity and factor endowment serves as the basis for trade.

In a situation with no trade abundant factors of production will receive relatively low rents / wages while scarce factors will receive high rents / wages. According to the Stolper-Samuelson theorem an equalisation of factor prices will take place if there is trade. Consequently abundant factors in an economy gain from trade liberalisation and scarce factors loose<sup>41</sup>. Consumers would equally enjoy a lower price on goods that are intensive with respect to scarce factors of production. It also follows from this neo-classic development of trade theory that trade has distributive effects which might spur protectionism. As Maurice Obstfeld states: "According to the usual Heckscher-Ohlin reasoning, increased trade between high wage United States and low wage Mexico has a depressing effect on wages of low-skilled American workers, who must find new jobs in sectors that previously had employed relatively few of them"<sup>42</sup>.

However, according to Heckscher and Ohlin, any single country would gain by exporting goods that are relatively cheap on their home markets (because of national factor endowments) and importing goods, which are relative expensive on their home markets as compared to the world market. Thus, the concept of comparative advantage was expanded as to include not only labour productivity but also factor endowments.

Furthermore, the Heckscher-Ohlin theory states that countries that are rich on capital and relatively short on labour can be expected to export capital intensive goods and to import labour intensive goods. The imports of the USA could therefore be expected to be relatively labour intensive and exports relatively capital intensive. In the 1950's Wassily Leontief analysed the USA's foreign trade in order to test the relevance of the Heckscher-Ohlin theory<sup>43</sup>. Surprisingly he discovered that the imports of the USA contained 30% more capital pr. worker than the exports. This apparent paradox ("Leontief's Paradox") can, however, be explained by the fact that the labour of the USA at that time was generally better educated and more efficient than the labour of the trading partners. If education is regarded as an investment and wages as a return on capital invested in education, the exports of the exports of the USA are in fact more capital intensive than estimated. This actually solves the paradox initially envisioned by Leontief<sup>44</sup>. Furthermore, the USA is relatively poor in some raw materials, which therefore must be imported. Equally the USA arguably has a technological lead as compared to its trading partners and is able to export patented goods for which there is a demand

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<sup>40</sup> Krugman and Obstfeld (1997) op. cit., p. 67.

<sup>41</sup> Dani Rodrik, "Symposium on Globalization in Perspective: An introduction". *Journal of Economic Perspectives*. Vol. 12, no. 4, Fall 1998, p. 5.

<sup>42</sup> Maurice Obstfeld, "The Global Capital Market: Benefactor or Menace?". *Journal of Economic Perspectives*. Vol. 12, no. 4, Fall 1998, p. 21. Obstfeld refers to Robert A. Mundell, "International Trade and Factor Mobility". *American Economic Review*. June 1957, 47, 321-35.

<sup>43</sup> Wassily Leontief, Domestic Production and Foreign Trade: The American Capital Position Re-Examined". *Proceedings of the American Philosophical Society*, 97, 1953, pp. 331-349.

<sup>44</sup> Strøjer Madsen, Ulf-Møller Nielsen, and Pedersen (1984), op. cit., p. 28.

regardless of their factor intensity<sup>45</sup>. A similar reassessment of factor endowments probably applies to most rich and developed countries.

Although the Heckscher-Ohlin theory is not rejected by Leontief's Paradox this does not mean that it explains world trade today. In theory, one should expect world trade to take place primarily between rich developed and developing countries (i.e. between North and South) that are relatively different in terms of factor endowments. However, world trade primarily takes place between developed countries. In other words, trade is between countries with similar factor endowments. For this there are several explanations, some of which are similar to the one stated above concerning Leontief's Paradox. Market imperfections and economies of scale are important (I shall return to this later), but goods also differ from one another with respect to other factors than factor intensity. Trade in virtually identical goods (e.g. automobiles) constitutes a substantial share of world trade. These goods differ with respect to style, quality, image and the like, and often these factors are as important to trade as factor intensity / endowments.

In spite of these modifications of classic Ricardian trade theory notion of comparative advantages of trade is still, 180 years on, the fundamental axiom of theory of international trade. Apparently, it is by no means offset by the neo-classic developments of trade theory (Heckscher-Ohlin / Samuelson) or theories on increasing returns to scale or theories on strategic trade policy<sup>46</sup>.

The benefits of free trade will exceed losses increasing the welfare of all both individual and society. This does not mean that there will be no losers when capital and labour are moved from less competitive industries to more competitive ones. The point is, however, that winners will be able to compensate losers and still be better off than without trade. Secondly, from Ricardo's point of view such compensation would always take place within the borders of the individual trading nations. This is because Ricardo assumed that capital would only move within borders not across them. Therefore, both losers and winners would always reside here. In the light of this, the need for an international trade regime is questionable. On the other hand, if you (more realistically) allow for international capital mobility the individual benefits of free trade are equally questionable.

In the following I will discuss the nature of the gains resulting from free trade and the possible national interests in trade liberalisation in order to draw a connection between trade theory and regime theory. The point is that such a connection is often lacking in analyses of the international trade regime.

### **The benefits of trade liberalisation**

International trade can be regarded as a good because it involves potential economic benefits in the form of increased production and economic growth. This economic benefit is the immediate result of the specialisation associated with the international division of labour facilitated by trade. Trade allows for specialisation whereby a better allocation of resources is attained exactly in the same way a na-

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<sup>45</sup> Ibid.

<sup>46</sup> For a discussion on this see Krugman (1987) op. cit..

tional division of labour would have been. One might call this the (economic) benefits of specialisation.

In order to exploit the potential of an international division of labour the movement of goods has to be as free as possible. There is of course a “natural” cost involved in trade between countries such as transportation costs. Different kinds of trade regulations can, however, also inflict costs on the exchanges of goods over borders. Tariffs constitute the most direct cost of trade, but different forms of non-tariff barriers to trade such as technical standards or environmental regulations can indirectly inflict serious cost on traded goods.

Free trade describes a situation where both tariff and non-tariff barriers to trade are as small as possible so that the potential gains from trade are maximised. It is the purpose of international agreements on trade such as the GATT / WTO-agreements to increase the likelihood that the barriers to trade will in fact be minimised. Securing co-operation about this is in itself a public good for the trading members of the regime. One might call this the benefits of regulation.

The benefits of specialisation and the benefits of regulation are, of course, closely connected in that the benefits of specialisation depend on successful enforcement of trade agreements. For the purposes of this discussion, however, it is useful to distinguish between the two goods.

The point is that the capital previously invested in the less competitive national industries will be invested in the more competitive ones instead (regardless of whether one bases the argument for free trade on Smith’s absolute advantages or Ricardo’s comparative advantages). The argument is based on the important condition that only goods and not capital move over borders. Capital only moves between different branches (or industries) and only within national borders. Therefore the allocative benefits of specialisation and the international division of labour will not only yield a total (global) gain, it will also yield a gain for any single state engaged in trade. If we, on the other hand, allow capital to flow freely across borders there will still be a total gain from trade (and possibly an even greater one). However, trade will now only be possible in the presence of absolute advantages, or rather, absolute advantages (not the comparative ones) will decide whether there will also be a gain for any single state<sup>47</sup>.

Ricardo himself explicitly assumed that the international mobility of capital was insignificant (or even absent) as compared to national mobility of capital. Furthermore, he explicitly stated that this was a precondition for the theory of comparative advantages and for the mutual benefits of free trade predicted by the theory:

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<sup>47</sup> Please note that there can also be significant differences in the national mobility of capital of different countries. In some countries it might be easier to move capital from one part of the industry to another than in other countries because of differences in the types of industries in question, factor endowments, skills of worker, and the like. This can be an additional distributive factor affecting the national interests in trade and the dilemmas of collective action associated with trade liberalisation. As such even without international mobility of capital sharpening the elements of rivalness / divisibility of free trade there can be important incitements for protectionism because of differences in the ability to adapt to the international competition associated with trade.

*“In one and the same country, profits are, generally speaking, always on the same level; or differ only as the employment of capital may be more or less secure and agreeable. It is not so between different countries. If the profits of capital employed in Yorkshire, should exceed those of capital in London, capital would speedily move from London to Yorkshire, and an equality of profits would be effected; but if in consequence of the diminished rate of production in the lands of England, from the increase of capital and population, wage should rise, and profits fall, it would not follow that capital and population would necessarily move from England to Holland, or Spain, or Russia, where profit might be higher”<sup>48</sup>.*

And though he recognised that international mobility of capital would theoretically make the allocative benefits of free trade even greater he assumed that in practice it would not affect the terms of trade:

*“It would undoubtedly be advantageous to the capitalist of England, and to the consumers in both countries, that under such circumstances (i.e. with Portugal having the absolute advantages on all commodities), the wine and the cloth should both be made in Portugal, and therefore that the capital and labour of England employed in making cloth should be removed to Portugal for that purpose.....*

*Experience, however, shows, that the fancied or real insecurity of capital, when not under the immediate control of its owner, together with the natural disinclination which every man has to quit his country of birth and connections, and entrust himself, with all his habits fixed, to a strange government and new laws, check the emigration of capital”<sup>49</sup>.*

Thus in Ricardo’s classic example with trade between England and Portugal all mobile resources would be allocated to Portugal - rendering England deprived of both labour and capital (if labour and capital were perfectly mobile). The assumption of in-mobility of capital was perhaps quite realistic in the days of Ricardo, but today this is no longer true. Today capital is generally even more mobile than labour and as such free trade has significant distributive effects potentially affecting the establishment of an international trade regime. The question is what kind of a public good is free trade really; what are the dilemmas of collective action involved; and what kinds of national interests can you expect to encounter within the WTO-regime in the light of today’s global economy?

### **Capital mobility, market imperfections, and free trade as a public good**

In the previous section it has been suggested that free trade is a public good and that the PD impedes the establishment of an international free trade regime between rational actors pursuing their individual national interests. The question is, as stated above, how this dilemma presents itself as seen from the perspective of some of the basic propositions of the classic theory of international trade. Furthermore, the question is; what role can an international trade regime such as the WTO be expected to play in the solution of dilemmas of collective action. This demands a closer look at the concept of free trade.

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<sup>48</sup> David Ricardo, *Principles of Political Economy and Taxation*. G. Bell and Sons, Ltd., London 1927, p. 114. (1<sup>st</sup> ed. 1817). Exactly these views of Ricardo have also been noted by Herman E. Daly and John D. Cobb (1989 op. cit., p. 214.

<sup>49</sup> Ibid., p. 116-117. (Parenthesis added)



In this connection I will define free trade as a “condition” where trade (e.g. trade in goods) over borders involves the least possible costs in terms of tariffs and non-tariff barriers to trade. Transportation costs and similar “natural” costs of trade are not counted as barriers to trade in this connection.

Free trade, however, should be regarded as a final goal of an international trade regime, the value of which can only be measured against a condition of less free trade i.e. with more (tariff and non-tariff) barriers to trade. In fact, the good, which has been negotiated during a number of so-called “rounds” of trade negotiations (the Uruguay Round being the latest) is concrete successive steps towards this final goal. So when we speak of free trade what is meant here is more precisely trade liberalisation in the form of lowering of tariffs and removal of non-tariff barriers to trade.

As mentioned above free trade can be said to consist of two “components”: The benefit of deregulation and the resulting (economic) benefit of specialisation. The two components are closely related, but analytically separated, in much the same way as the concepts of divisibility and rivalry. For analytical purposes, it is therefore convenient to keep them separated and distinguish between:

- Trade liberalisation in itself (e.g. a specific cut in tariffs)<sup>50</sup>.
- The effects of trade liberalisation (e.g. a rise in GNP).

The two aspects of trade liberalisation can be evaluated against the central properties of public goods: Divisibility, rivalness and excludability. Furthermore it is primarily the characteristics of the economic effects of trade liberalisation that influences the establishment of an international free trade for collective decision-making on trade liberalisation.

In the following it is assumed that the economic effect of a given reduction of tariffs or non-tariff barriers = the utility of that same reduction (i.e.  $\Delta \text{BNP} = \Delta \text{Utility}$ ). Taylor distinguishes between the amount of, and the benefit of, the good accessible to any individual and he emphasise that the former relates to the concept of divisibility and the latter to the concept of rivalry. One speaks of divisibility when, and if, consumption reduces the amount of the good available to others. Where there is rivalry consumption reduces the benefits to other consumers. Thus, the two concepts are analytically distinct although in practice they are often closely related. Here I assume they are directly proportional<sup>51</sup>.

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<sup>50</sup> Note that this aspect of trade liberalisation as a public good includes the implementation and enforcement of trade agreements (such as the punishment of free-riders). This in itself constitutes a dilemma of collective action the solution of which has been associated with the presence of hegemonic leadership. See e.g. Conybeare (1984) op. cit. ; Joanne Gowa, “Rational Hegemons, Excludable Goods and Small Groups: An Epitaph for Hegemonic Stability Theory?”. *World Politics*. Vol. XLI, no. 3, April 1989, pp. 307-324; Duncan Snidal, “The Limits of the Hegemonic Stability Theory”. *International Organization*. (39), 1985, pp.579-614.

<sup>51</sup> Taylor points to public beaches and parks as examples of goods with no direct relationship between divisibility and rivalry. Some people prefer a semi-crowded beach or park to an empty one. Amount and benefit are inversely proportional until a certain threshold of “crowding”. Taylor (1987) op. cit., p. 7.

Regarding trade liberalisation (i.e. reductions of trade barriers) it is evident that its status as a public good is dependent upon the specific GATT agreements in question. The “National Treatment” (NT) and the Most Favoured Nation (MFN) principles mean that a given cut in tariffs applies to all members of the trade regime equally. Thus a cut in tariffs for country A means that it applies equally to country B. As such the reductions of tariffs or the removal of non-tariff barriers can be seen as indivisible and jointly supplied goods. It is possible to make tariff reductions accessible for all members of the regime, but differentiated reductions are also possible (e.g. lower general tariffs for developing countries than for industrialised countries). However, possibilities for negotiating bilateral agreements or regional free trade areas such as the EU can make trade liberalisation more or less divisible (de facto).

It is also evident that trade liberalisation is excludable. In order to enjoy the privilege of low tariffs a country has to be accepted as a member of the regime. Access is restricted and it is possible to adopt or exclude members, but this of course also depends on the specific wording of the agreements. Note that the enforcement of the GATT / WTO-agreements is a public good in itself for the members of the regime (since it is associated with costs). Furthermore, the benefits of it are indivisible and non-excludable vis-a-vis the members of the regime although some members of the regime might be more interested in enforcement than other members.

In conclusion, it depends on the specific wording of the trade agreements whether trade liberalisation (i.e. reductions of tariffs and non-tariff barriers) is indivisible and non-excludable. It is also evident that even if tariff reductions are in fact indivisible and non-excludable this is not particularly critical for collective action. The nature of the benefits associated with trade liberalisation are more likely to involve dilemmas of collective action, but not exactly in the way predicted by the theory of collective action. The question is, are the effects of trade liberalisation excludable and indivisible or rival?

Regarding the effects of trade liberalisation: The (economic) benefits of free trade or reductions of tariffs or non-tariff barriers are in principle non-excludable, but agreements or privileges can be withdrawn. In a “one-shot game” like the classic PD game withdrawal is of course not an option, but when the game is iterated (which is the case with trade negotiations) and if individual contributions are not vital, excludability is increased.

Regarding divisibility / rivalness: A reduction of tariffs would according to the classic theory of international trade increase the total economic output (GNP) of the trading countries as a result of the international division of labour. The total change in GNP resulting from a cut in tariffs would be of a certain magnitude (say \$10 mill.). This increase in GNP would at least on the short view be a fixed divisible figure. The part of the total increase in GNP that goes to country A cannot at the time be enjoyed by country B which in effect is excluded from enjoying that part of the total increase in GNP. The total economic gain from trade liberalisation is therefore as perfectly divisible as an apple pie.

You might argue that although the benefits of specialisation are in principle divisible they are not rival in any significant way since the total benefits ( $\Delta$  GNP)

increase even more as the number of trading countries increase<sup>52</sup>. (There might be a positive correlation). However, the fact that total benefits increase as the number of trading countries increase does not in itself make these benefits non-rival, since it is possible to have increasing total gains and decreasing individual gains (or losses) at the same time.

The conclusion is that the benefits from trade liberalisation in terms of economic growth are both divisible / rival and excludable as seen from the perspective of individual countries. Regardless, trade liberalisation yields a total benefit for the trading countries collectively. It is a public good for the trade regime as a whole inasmuch as the benefits that are potentially available to any single country are not diminished as the number of countries participating in the trade regime increase. In practice the distributive effects of trade liberalisation will decide the degree of rivalness associated and therefore the likelihood of a successful international free trade regime. Therefore, the distributive effects of trade are important in defining the dilemmas of collective action associated with international co-operation on trade liberalisation.

The fact that the benefits of free trade and trade liberalisation are not equally distributed does not necessarily give strong incitements for protectionism. This depends on the importance attributed to relative as opposed to absolute benefits of international co-operation. As seen from a neo-realist perspective the relative gains associated with free trade will be important, whereas neo-liberal perspectives would emphasise absolute individual gains. However, even if single countries are only interested in individual (absolute) gains, dilemmas of collective action might still apply if it is advantageous to uphold trade barriers (e.g. an optimal redistributive tariff)<sup>53</sup>. The incitement for protectionism increases if the benefits of single countries are interdependent in some way and if co-operation in the field of trade liberalisation resembles a zero-sum game as seen from the perspective of individual countries in spite of any possible global gains. Of course on a global scale the game is still a positive-sum game, but the distributive effects of trade liberalisation might render individual countries worse off than with less free trade (i.e. there might be both absolute and relative national losses). In fact, there are 4 main types of winners and losers: Absolute winners, absolute losers, Relative winners, and relative losers. Any single country might in turn be characterised by a combination of these main types (e.g. it can be an absolute/relative winner, absolute/relative loser, absolute winner/relative loser, and a relative winner/absolute loser. In this connection, capital mobility plays an important role<sup>54</sup>.

In determining the potential conflicts and dilemmas of collective action involved in trade liberalisation it is important exactly how the benefits of trade are distributed among the members of any given free trade regime. In other words, the way in which the problem of global allocation is solved is important. More specifically, it is important whether there are factor movements between countries or only within single countries as in Ricardo's classic trade theory.

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<sup>52</sup> This property of free trade is emphasised by Erik Beukel classifying trade as a "Toll Good" (which is non-rival). See Erik Beukel, "Imperfections of Markets and Governance: The International Political Economy of Public Good Regimes – An Introductory Discussion". (DUPI, November 1998).

<sup>53</sup> Conybeare (1984) op. cit.

<sup>54</sup> In a simple two-country model, the combination "relative winner/absolute loser" means that total output has diminished.

If capital only moves within countries the benefits of any single country will be decided by the national differences in productivity (i.e. comparative advantages serves as the basis for trade). These differences in productivity are hardly interdependent to any significant extent and therefore the benefits are neither. Thus the benefits of country A will not be cashed at the expense of country B and as such they are quite non-rival.

If capital, on the other hand, moves between countries the distribution of the benefits from trade will be decided by international differences in productivity (i.e. absolute advantages serve as the basis for trade). Even if these differences are not directly interdependent in any way, the benefits themselves are. The benefits (in terms of economic gains) will be gained directly at the expense of country B thereby adding a certain amount of rivalness to trade liberalisation.

Obviously, there can be major differences between countries concerning the mobility of certain (production) factors. This does not only apply to labour, which has rather low mobility<sup>55</sup>, and capital, which is relatively mobile. The international mobility of capital also varies depending on the type of capital in question. Foreign direct investments (FDI) (and portfolio investments) are relatively mobile while other types of capital such as machines, buildings and natural resources are relatively less mobile. However, capital has become significantly more mobile as a part of the general trend of economic globalisation and the development of information technology. The international mobility of labour, on the other hand, has not increased at nearly the same pace for both legal and cultural reasons.

In this connection, the basic conclusion of classic trade theory (that factor mobility generally yields economic gains and an increase in global economic output) is not seriously challenged. The conclusion; that any local loss of production triggered by movements of production factors are more than offset by the increase in production yielded by that very same factor mobility, is not in any way questioned either. Nor are the neo-classic conclusions concerning international differences of factor endowments (Heckscher/Ohlin), relative factor / commodity prices (Stolper-Samuelson), or the importance of international equalisation of factor prices on the world market<sup>56</sup>.

Classic theory of international trade based on comparative advantages does not, however, conclude that there will be no losers when tariff and non-tariff barriers are removed and trade increases. The point is that winners will be able to compensate losers and still be better off than in a situation with no trade at all. The problem is, that classic trade theory assumes that both winners and losers will be situated within national borders because of the relative (international) in-mobility

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<sup>55</sup> Labour mobility also varies historically, and in the last century the world experienced significant international migrations especially to USA.

<sup>56</sup> The distribution of the economic benefits of trade among the trading countries depends on a number of factors including how international prices are determined. In practice prices will not equal those of home markets of any single country. In stead, an international market will emerge where prices will find a level somewhere between different national market prices. These international market prices will usually be nearest to those of big countries because their influence on international prices is the most significant. Small countries are therefore likely to gain more from trade than the big ones since their national market prices differ the most from international market prices. See Erik Strøjer Madsen, Jørgen U.M. Pedersen, Kurt Pedersen (1984) op. cit.

of capital<sup>57</sup>. With international mobility of capital winners and losers will not only be situated in different industries or branches they will also be situated different countries based on absolute advantages.

Therefore, international mobility of capital seriously complicates the question of compensation. The likelihood of compensation between countries is much smaller than within single countries. Assuming states are the most important single actors establishing an international trade regime, protectionism is likely to affect both negotiations on trade liberalisation and the management of trade agreements. In other words, the likelihood of protectionism is inversely proportional with the likelihood of compensation<sup>58</sup>. Free trade will still be a public good in the sense that it will increase the total welfare of the trading countries. International mobility of capital, however, supplies it with a strong element of rivalness / divisibility.

### Strategic trade

From the discussion above it appears that the international mobility of capital affects the political economy of the international free trade regime and the negotiations on trade liberalisation. It also appears that capital mobility in itself does not affect the “collective” argument for free trade. However, international mobility of capital is not the only critical aspect of international trade affecting the argument for free trade. Krugman points to the “counter-culture” of international trade theory which has emerged since the 1970’s and 80’s, and which on several accounts challenged the almost unanimous celebration of classic trade theory and the notion of comparative advantages as the basis for trade<sup>59</sup>. At first no one questioned that free trade was an advantages for everybody, but eventually the notion of individual (national) advantages was indeed questioned.

Although the global allocative benefits of free trade were more or less recognised it was suggested that certain types of regulative intervention might be a good idea as compared to unconditional trade liberalisation. As Krugman puts it: “...showing that free trade is better than no trade is not the same thing as showing that free trade is better than sophisticated government intervention”<sup>60</sup>.

The critical approach to the laissez faire philosophy of classic trade theory is evident and the new type of models which according to Krugman challenge the con-

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<sup>57</sup> Neo-classic versions of trade theory do consider various sorts of factor mobility (including mobility of capital), but apparently this has had no consequences as to whether comparative or absolute advantages serve as the basis for trade and the total benefits there-of in terms of increased economic output. For a critical view of the comparative advantage argument stressing the importance of international mobility of capital see Herman E. Daly, *Beyond Growth*. Beacon Press, Boston 1996; and Tim Lang and Colin Hines, *The New Protectionism*. Earthscan, London 1993.

<sup>58</sup> This applies to the national level of decision making as well. Here the likelihood of protectionist interests gaining way depends on the likelihood of compensation between labour and capital following eventual losses for one of the parties. See Robert E. Baldwin, “The Political Economy of Trade Policy”. *Journal of Economic Perspectives*. Vol. 3, no. 4, Fall 1989, pp. 119-135.

<sup>59</sup> Krugman (1987) op. cit., p. 132.

<sup>60</sup> Ibid. p. 134.

ventional wisdom underline the significance of increasing returns / economies of scale and imperfect competition.

The novelty of the new models is not that specialisation and international division of labour result in increasing returns to scale, which in turn is in itself an argument for free trade. (Economies of scale only add to the argument of free trade). Neither is it that economies of scale has a built in conflict since increasing returns will lead to imperfect competition and breed monopolies. The new aspect is that these underlying forces behind free trade do not necessarily create mutual and individual benefits for any single country involved in trade, and not least, that it is possible to affect the terms of trade by way of “strategic trade policy”. These strategies would aim at ensuring national companies excess returns from monopolistic and oligopolistic markets. Interventionist policies aimed at supporting industries yielding positive externalities (i.e. technological innovations and “know how”) is another argument for diverting from a national laissez faire trade policy. Interventionism serving national interests in supporting certain industries can interfere with free trade in a number of ways depending on how interventions are designed. Under all circumstances interventionist policies imply a risk of trade disputes (or even trade wars) if the policies are designed so as to secure national interests at the expense of other countries.

Brander and Spencer have emphasised that it pays for any single nation to support national industries through export subsidies or import restrictions in order to discourage foreign companies from competing on lucrative markets with possible monopolistic profits (i.e. markets where there is only room for one or very few companies)<sup>61</sup>. Krugman shows that the fight for control over international monopoly markets can be won applying strategic subsidies supporting the national companies in question<sup>62</sup>.

Even if the theoretical modifications of pure classic trade theory and the conclusions concerning increasing returns, economies of scale, and imperfect competition have been quickly accepted within the profession, the political consequences in the form of protectionism or interventionism have been sharply criticised not the least by some of the creators of the theories themselves<sup>63</sup>. The critique contains a significant scepticism concerning the possibilities for correcting the market

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<sup>61</sup> James A. Brander and Barbara J. Spencer, “Export Subsidies and International Market Share Rivalry”. *Journal of International Economics*. 1985, 18, pp. 83-100; and “International R&D Rivalry and Industrial Strategy”. *Review of Economic Studies*. 1983, 50, pp. 707-722.

<sup>62</sup> Krugman envisions a situation with two countries each with one single firm considering investing in production of a high technology product (e.g. an aeroplane). There is only room for one company at the world market, and as such the costs of developing the product will be in vain if both of them decides to enter the market. If, however, only one of them enters the market there will be significant excess profits to gain from being on a monopoly market. If neither of them decides to enter the market the gains will be zero for both parties. (In other words the game resembles a “chicken game”). The point is that by introducing a government subsidy any single country can make sure that their “own” company will enter the market no matter what their opponents choose to do. Theoretically, this will tip the game in favour of the company receiving the subsidy by discouraging their opponents. See Krugman (1987) op. cit., pp. 135-37. Please notice that this only solves the dilemma as seen from the perspective of the individual company involved. As seen from a national perspective this only adds an extra “layer” to the dilemma since any country will now have to consider the possibility of a similar subsidy being supplied to foreign companies.

<sup>63</sup> Krugman (1987) op. cit., p. 137.

failures of international markets and trade. There is an overriding danger of “government failure” (or regulation failure). It is simply empirically difficult to gain knowledge of the possible benefits of supporting large industries operating on oligopolistic markets. Another unknown factor is that it can be difficult to estimate to what extent you are actually dealing with a monopolistic or oligopolistic market. If instead of only one company there is actually room for 4 or 5, excess profits will be eliminated by competition and you risk a situation where subsidies will only benefit foreign consumers<sup>64</sup>. A third reservation concerning interventionism is that subsidies or protectionist measures can distort domestic markets by raising prices on certain resources there. Thereby those industries or companies not receiving government subsidies are disfavoured which in turn might result in a total national loss.

Although increasing returns, market imperfections, and international mobility of capital challenge the notion of free trade as an advantage for any single country as well as for the trading countries collectively it is not at all certain that interventionist policies will fix it. Apart from the problems already mentioned there are also political costs associated with protectionist intervention. These cost turn up concerning the relations to trading partners and concerning special national interests in protectionism. The national political costs turn up when interventions are not the result of rational economic considerations but are a result of political pressure from special interest groups. There is a built in danger of this associated with the asymmetries of interests resulting from benefits of interventionism / protectionism being concentrated while costs are spread<sup>65</sup>. The international political costs emerge when protectionism and strategic interventionism are met with counter measures resulting in a situation where all are worse off than if no one had interfered with free trade. Even if free trade is not exactly characterised by the harmony of interests associated with classic Ricardian trade theory there is still a collective interest in abstaining from interventionism. In other words, there might still be a PD with free trade being the only Pareto-optimal outcome<sup>66</sup>. Here, the collective interests in trade liberalisation are rather to be found in the international political game surrounding the international trade regime (WTO) than in the nature of the benefits of free trade itself.

## Conclusions

In conclusion, there are several sources of conflict relating to international co-operation on trade liberalisation. It also appears that the conflicts are not the result of free trade being a public good in the traditional sense of the word. The dilemmas of collective action that an international free trade regime is supposed to solve do not necessarily take the form suggested by rational / public choice and regime theories on international co-operation (to which I will turn in the next section).

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<sup>64</sup> An illustrative example might be the widespread subsidies for shipyard industries. These are probably not supplied in order to exploit monopolised markets but rather because of political desires to maintain heavy industries (and whatever positive externalities associated). However, there is no doubt that a part of the subsidies in effect benefits the customers of the shipyards supplying ships at a lower price than would otherwise be possible.

<sup>65</sup> Krugman (1987) op. cit., p. 142.

<sup>66</sup> Ibid.

The establishment of an international free trade regime is not necessarily the positive-sum game described in regime theories. Not all countries would necessarily be interested in trade liberalisation. (Neither generally nor in specific fields of trade e.g. trade in industrial goods, agricultural products or services). Inasmuch as lack of international regulations leads to trade disputes (or trade wars), however, there might be a collective interest in a trade regime independently on single countries economic benefits from trade liberalisation. In other words, there might also be serious costs of not having a trade regime.

The purpose of the discussion above has been to suggest that international mobility of capital and market imperfections (in the form of increasing returns to scale, strategic trade policies, and protection of infant industries) adds a certain amount of rivalness to free trade. The neo-classic and other modifications of traditional Ricardian trade theory do not, on the other hand, change the fact that there is a global benefit (of allocation) associated with trade liberalisation. However, the distributive effects of such a liberalisation make the establishment of an international trade regime more difficult than suggested by the dilemmas of collective action normally associated with the provision of public goods.

Starting from Ricardo's notion of comparative advantages there is not necessarily an equal distribution of the benefits of free trade either, but for any single country there will always be some benefit (big or small). Compensating losers will under conditions of zero capital mobility be a strictly national business of redistribution while under conditions of mobile capital it will be an international one. The different perspectives of regime theory relevant for analysing the negotiations of GATT agreements and the settlement of trade disputes within the WTO system should be seen in the light of this.

That free trade is not necessarily the optimal solution for any single country has long been recognised by neo-classic trade theory but apparently, this has had no influence on neo-liberal international political economy and IR-theory concerning the international trade regime<sup>67</sup>. It is, however, relevant to consider the nature of free trade as a public good in relationship with the various regime theories explaining the establishment of GATT / WTO and the political decision-making processes on the removal of trade barriers. What does it mean to say that for big countries like USA free trade might not be the first best solution? Conybeare points to the fact that big countries can improve their terms of trade by imposing an "internationally redistributive optimal tariff"<sup>68</sup>. Thus, foreign exporters are forced to lower prices in order to be able to sell their goods, but if the export country is big enough there is a risk of retaliation. Thereby the welfare of both countries is reduced as compared to a situation with no tariffs. This resembles the situation of strategic trade policy and furthermore looks like a PD where the only Pareto-optimal solution is free trade (or negotiated tariff reductions).

The so-called "hegemonic stability theory" points to the national interests of the USA in international free trade and to its leadership role in establishing an interna-

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<sup>67</sup> Conybeare (1984) op. cit. p. 10.

<sup>68</sup> Ibid., p. 11.



tional free trade regime in the post war international society<sup>69</sup>. As seen from the perspective of international trade theory, however, it is not at all likely that hegemonic actors will act as political entrepreneurs.

In the following I will discuss some of the fundamental propositions of the regime theories that might be applied explaining the establishment of an international trade regime in general and the role of institutions such as the WTO in particular. What are the connections between trade theory and regime theory?

## ***Regime Theory and Trade Liberalisation in the WTO***

### **Introduction**

The international trade system described in the GATT agreements and institutionalised by the establishment of the WTO is a typical example of what has been called an international regime in the field of IR-theory. The purpose of an international regime is to secure collective interests and provide collective public goods among autonomous rational actors (states) in an anarchic international system with no central authorities. The purpose of the WTO is to secure the alleged collective interests in free trade through co-operation on trade liberalisation and removal of trade barriers.

Hasenclever, Mayer and Rittberger identifies three main “schools of thought” within regime theory: Interest-based (Neo-liberal), Power-based (Realist), and Knowledge-based (Cognitivist) theories of international regimes<sup>70</sup>. The analysis of international co-operation within the different “schools” of regime theory is based on certain basic propositions about actors and their interests. The likelihood of co-operation regarding collective interests under conditions of formal anarchy depends more or less on these basic propositions.

It is a central assumption of theories of collective action that except under certain conditions of iteration and transparency the provision of public goods implies the presence of a central authority (a Leviathan<sup>71</sup>) that is able to enforce contributions to the provision of public goods and / or compliance with agreements. In the absence of central authorities, PD and free-rider dilemmas will inhibit sufficient provision of the good. Within national borders, the state plays the role of a Leviathan, but in the international system of states, there is no such central authority.

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<sup>69</sup> Conybeare questions the theoretical basis for the hegemonic stability theory. Ibid. Joanne Gowa defends the theory Gowa (1989) op. cit.. For another critical discussion see Duncan Snidal (1985) op. cit. With special relevance to the field of international trade see e.g.: Stephen D. Krasner, (1991) op. cit. or his “State Power and the Structure of International Trade”. *World Politics*, 28, April 1976 and Keohane’s discussion of Krasner’s conclusions in Robert O. Keohane, “Problematic Lucidity: Stephen Krasner’s “State Power and the Structure of International Trade””. *World Politics*, 50, 1, 1997, pp. 150-170.

<sup>70</sup> Hasenclever, Mayer, and Rittberger (1997) op. cit.

<sup>71</sup> After Thomas Hobbes, *Leviathan*. (1651).

In the absence of central authorities or hegemonic actors (capable of taking on the role of a Leviathan), the central proposition of regime theory is that the establishment of principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area<sup>72</sup> will help rational actors to forgo individual short term interests and co-ordinate behaviour in order to secure long term collective interests and to avoid Pareto-suboptimal outcomes.

Especially from the perspective neo-realist regime theories, the USA has been described as a hegemonic leader with a firm interest in the public good in question (free trade) thus giving rise to the hegemonic stability theory. Furthermore, this interest is supposed to be so important that the hegemonic actor is either willing to provide the good unilaterally (benevolent hegemony) or alternatively, to enforce the necessary contributions (coercive hegemony)<sup>73</sup>. Both alternatives inflict costs on the hegemon and especially in the situation of benevolent hegemony the beneficiaries can be described as a “privileged group”<sup>74</sup> (Note that the enforcement of compliance with agreements is therefore, as mentioned above, in itself a public good). In the eyes of the neo-liberals, however, order or collaboration in the field of international trade (and in other issue-areas) does not have to be imposed by hegemonic leaders. “Negotiated orders” between autonomous actors are indeed possible, if international institutions or concrete organisations (such as the WTO) are established and if uncertainty is reduced, transparency is increased, and games are iterated. The essence of regime theory is that regimes are negotiated orders – not imposed by hegemonic actors<sup>75</sup>.

From the perspective of international trade theory and the predicted distribution of the benefits of free trade the interpretations and analysis of the international trade regime (WTO) suggested by some of the regime theories are questionable. One of the critical assumptions is the notion of free trade as public good and of trade liberalisation as collective interests of all countries. This more or less serves as a point of departure for most regime theories on the establishment and management of the international trade regime.

Both neo-liberal and neo-realist regime theories rely heavily on collective action theory and game theory (even if they do not seek to describe the international trade regime in terms formal models with the aim of predicting political outcomes). In this connection, the notion of free trade as a public good has been central in explaining both the general interests in free trade and the need for mechanisms to secure co-operation among rational actors.

A central point of the discussion above has been that if certain modifications of classic, Ricardian trade theory are considered the demand for international co-operation in the field of trade does not seem as logical as the neo-liberal regime theories would have it. As such the distributive effects of free trade are central to the understanding of both regime formation and regime maintenance in the field of international trade. This has long been a central point of the neo-realists stressing the importance of relative gains and balances of power whereas the neo-

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<sup>72</sup> Krasner (1983) op. cit.

<sup>73</sup> The benevolent / coercive dichotomy was introduced by Duncan Snidal (1985) op. cit.

<sup>74</sup> Olson (1965) op. cit. p. ?

<sup>75</sup> For a discussion of spontaneous, imposed, and negotiated orders see Young (1989) op. cit., pp 84 ff.

liberals have stressed the importance of absolute individual gains associated with trade. In general, both regime formation and regime maintenance in the field of international trade is more likely as seen from a neo-liberal perspective than as seen from a neo-realist perspective. But, as has been argued above, individual absolute gains of trade do not necessarily explain the existence of the international trade regime.

However, the distributive effects of trade inhibits international co-operation on trade liberalisation in a somewhat different way than predicted by neo-realist analyses of the international trade regime such as the one offered by Joseph. M Grieco in his analysis of the Tokyo Round negotiations<sup>76</sup>. The problem is not only the differences in relative gains associated with trade liberalisation. The risk of absolute losses seems equally problematic. This does not in itself contradict the neo-realist interpretations of the game of international trade liberalisation even if the game changes from a positive-sum game into a zero-sum game. In fact, there is really no serious conflict between the critique of classic trade theory presented here and the neo-realist propositions of Grieco. There only seems to be some unawareness, although the realists might argue that if relative gains matter they constitute a sufficient condition for conflict.

In the light of the modifications of classic trade theory discussed above, the problem of neo-realist perspectives is to explain co-operative outcomes of international trade negotiations. In particular it seems difficult to explain how an international regime such as the WTO has come about in the first place. Neo-realists apparently do not distinguish between the problem of negotiating a regime (i.e. moving up to the contract curve) and the problem of settling concrete disputes (i.e. moving along the contract curve to a single point)<sup>77</sup>. However, my point is that if you consider the modifications of classic trade theory as discussed above, absolute gains account for neither moving up to the contract curve nor moving along it to a single point. Something is missing and interpretations of international trade liberalisation should not rest entirely on the rationalist assumptions of main stream regime theory.

Although there are substantial differences between the neo-liberal and neo-realist schools of regime theory as to how co-operation might occur and as to how rational actors might agree on trade liberalisation there are also substantial similarities. This pertains especially to the notion of absolute gains associated with trade liberalisation. Discussions centre round the behavioural implications of absolute gains as opposed to relative gains. In brief, neo-liberals predict co-operative outcomes of the international trade regime, but for the wrong reasons (absolute gains are only global, and national gains may be absent). Neo-realists predict non-co-operative outcomes, but have difficulties explaining co-operative outcomes to the extent that propositions of hegemonic stability are not firmly supported (gains are always relative).

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<sup>76</sup> Joseph M. Grieco, *Cooperation among Nations: Europe, America, and Non-tariff Barriers to Trade*. Cornell University Press, Ithaca 1990.

<sup>77</sup> Ole Wæver, *Introduktion til studiet af International Politik*. Forlaget Politiske Studier, København 1992, p. 150. Wæver attributes a similar critical view of neo-realists to Keohane. However, an exact reference to Keohane is missing. (See also footnote 97).

The reflections on trade theory mentioned above give reason to consider alternative perspectives, which do not necessarily base their analysis of the international trade regime on the assumption that free trade is a public good, which in turn is subject of rational actions (and expectations) of WTO members. The political outcome of the international trade regime (i.e. the GATT agreements and the settlement of trade disputes under the WTO dispute settlement system) is not necessarily best explained by the neo-liberal and neo-realist perspectives inspired by rational choice theory and game theory. Cognitive (constructivist / reflectivist) perspectives emphasising institutional variables, organisational decision-making processes, and the social construction of interests might offer better (or complementary) explanations of the political outcomes of the trade regime, when rational action and interests of actors do not seem to tell the whole story.

In the following, I will briefly discuss some of the basic propositions of the different perspectives of regime theory. This in turn also serves as a basis for a more general discussion on the dynamics of the trade regime and of the role of WTO institutions in determining the political outcomes of the regime.

### IR-theory and regime theory

As mentioned above Hasenclever, Mayer and Rittberger use the terms “Interest-based”, “Power-based”, and “Knowledge-based” theories of international regimes. Here I shall stick to the terms “Neo-liberal”, “Neo-realist”, and “Cognitivist”<sup>78</sup> theories of international regimes. With respect to the neo-liberals and the neo-realists this trilogy fits the one often used in standard textbooks on international relations to describe the different schools of IR-theory<sup>79</sup>.

The “Globalist” and / or “Marxist” schools of IR-theory, however, do not seem to have any obvious counterparts within regime theory<sup>80</sup>. Most often their views

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<sup>78</sup> The terms “Reflectivism” and / or “constructivism” are also used to describe these perspectives. The former is used by Robert O. Keohane in *International Institutions and State Power: Essays in International Relations Theory*. Westview, Boulder 1989, pp. 158-79. The latter is used by Jeffrey Checkel (1998) op. cit.

<sup>79</sup> The terms “Realism”, “Pluralism” and “Globalism” are used by Paul R. Viotti & Mark V. Kauppi, *International Relations Theory* (2<sup>nd</sup> ed.). Macmillan Publishing Company, New York 1993. Charles W. Kegley and Eugene R. Wittkopf operates with even 6 different perspectives (most of which, however, can be subsumed under the ones mentioned by Viotti and Kauppi (1993) op. cit.). These are: (1) current history, (2) liberal idealism, (3) realism, (4) behavioralism, (5) neo-realism, and (6) neo-liberalism. See Charles W. Kegley & Eugene R. Wittkopf, *World Politics: Trends and Transformation*. (6<sup>th</sup> ed.). St. Martin’s Press, New York 1997, p 18. Bruce Russett & Harvey Starr, *World Politics: The Menu for Choice* (5<sup>th</sup> ed.). W. H. Freeman & Co., New York 1995 takes a more “cross-cutting” view focussing on the levels of analysis employed in the study of international relations: (1) (international) system level, (2) (international) relations level, (3) domestic level, (4) individual level. This view in many ways resembles the approach introduced by Kenneth N. Waltz in: *Man, State and War*. Columbia University Press, New York 1959. (Although Waltz only uses three levels of analysis: (1) international system, (2) state and society, and (3) individual).

<sup>80</sup> A Globalist IR-perspective does not necessarily entail a strictly Marxist view. Rather it represents a distinctive structural level approach to world politics. Immanuel Wallerstein is perhaps the best known representative of the Globalist school of IR-theory. See e.g.: Immanuel Wallerstein, *The Modern World System I*. Academic Press, New York 1974; *The Modern World System II*. Academic Press, New York 1980. A globalist view on the concept of international regimes is perhaps best represented by Susan Strange, “Cave Hic Dragones: a critique of regime analysis” in Krasner (1983) op. cit., pp. 337-354.

on international co-operation would probably resemble those of mainstream neo-realists reflecting a rather sceptic view on the notion of international regimes as either independent or intervening variables changing the effects of basic structural variables on international political outcomes<sup>81</sup>.

The same goes for the cognitivist versions of regime theory. These do not seem to have any obvious counterparts within general IR-theory. From a broad IR-perspective they might arguably fall within the category of neo-liberals, but from the perspective of regime theory their views on regimes and international co-operation in pursuit of common goals deviate substantially from the views offered by the interest-based neo-liberal perspectives. Arguably, the counterparts of cognitivist perspectives on international regimes are to be found within political and sociological institutionalism<sup>82</sup>. Likewise, the neo-liberals and the neo-realists are rooted in a broader theoretical framework of institutional economics<sup>83</sup>. Furthermore, the neo-neo perspectives have largely developed into a more or less coherent or integrated research project during the 1980's and 1990's. At the same time cognitive (or reflectivist / constructivist) perspectives have emerged as the only major alternative approach to the analysis of international institutions – or regimes.

No doubt the neo-realist and the neo-liberal schools of IR-theory have come to dominate the debate on international regimes bringing their basic assumptions and images of international relations with them in explaining the different forms of international co-operation. Their views differ with respect to the importance of state actors as opposed to non-state actors; to the extent state actors can be seen as (rational) unitary actors; and with respect to what issues are the most important in international relations.

In the eyes of the neo-realists states are the most important actors and furthermore, they are rational unitary actors when acting in the international system. Security and survival as independent actors are the most important issues in international politics and the most immediate concern of any state actor. Security is a

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<sup>81</sup> Stephen D. Krasner discusses the idea of regimes as intervening variables in "Structural causes and regime consequences: regimes as intervening variables" Ibid. pp. 1-21.

<sup>82</sup> For sociological perspectives on the new institutionalism and organisational analysis see e.g.: Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. The University of Chicago Press, Chicago 1991 or W. Richard Scott, *Institutions and Organizations*. Sage Publications, Thousand Oaks, Calif. 1995. For a political science perspective see e.g.: James G. March & Johan P. Olsen (1989) op. cit.

<sup>83</sup> Ronald Coase is often named as one of the "founding fathers" of institutional economics. See Ronald Coase, "The Nature of the Firm. *Economica*, 16, 1937, pp. 386-405; Ronald Coase, "The Problem of Social Cost. *Journal of Law and Economics*, 3, 1960, pp. 1-44, For an introductory discussion to new institutional economics see e.g.: E.G. Furubotn and R. Richter, *The New Institutional Economics: An Assessment?* in Eirik G. Furubotn and Rudolf Richter (eds.), *The New Institutional Economics*. J.C.B. Mohr (Paul Siebeck), Tübingen 1991. The relevance of institutional economics for the development of regime theory is its focus on the relationship between institutions and transaction costs. When property rights are well-defined there are supposedly few transaction costs associated with collective action (and therefore no need of central regulation) since optimal solutions could be negotiated on the market. This is sometimes referred to as the "Coase theorem". However, this was not Coase's own idea. Instead, he has questioned the idea of zero transaction cost concerning market transactions. See Mikael Skou Andersen, *Governance by Green Taxes: Making Pollution Prevention Pay*. Manchester University Press, Manchester 1994, pp40-41. Andersen refers to the preface of Ronald H. Coase, *The Firm the Market and the Law*. University of Chicago Press, Chicago 1988.

“high politics” issue whereas trade and economic interactions with other countries are considered “low politics” insofar as it is not immediately linked to security matters. From the perspective of neo-liberals both states and non-state actors such as transnational companies and international governmental (e.g. the WTO) and non-governmental organisations (NGOs) are important. Although states are recognised as the most important actors, they cannot be regarded as rational let alone unitary actors. Rather, their actions and decisions should be seen in the light of complex domestic political processes. Economic and environmental issues are just as important as security issues and at the margin perhaps even more important.

They do, however, agree on formal anarchy as the defining characteristic of the international system and, regarding the study of international regimes, the neo-liberals have even deliberately moved towards accepting the neo-realist assumption of rational state actors<sup>84</sup>. As such their research agenda seems to be integrated. They are both concerned with the question as to what extent international regimes (or institutions) can change the behaviour of rational actors (states) under conditions of anarchy. Only their conclusions differ. The neo-liberals are convinced that regimes do matter whereas the neo-realists are much more sceptical. The reason for this is to be found in their perceptions of how anarchy defines the interests and behaviour of rational state actors.

Important differences still remain between the neo-realist and neo-liberal perspectives on international regimes. Regarding international co-operation on trade liberalisation and the establishment of an international trade regime such as the WTO, the major difference between the two perspectives pertains to the importance of relative gains as opposed to absolute individual gains. In the view of neo-liberals, the importance of the latter makes the possibility of co-operation more likely than the neo-realists would agree to. Both perspectives, however, rely heavily on assumptions of rationality and interests / powers of actors (states). These assumptions cannot be made without referring to the benefits of free trade predicted by basic theory of international trade.

The discussion above has suggested that the distributive effects of trade, at least in theory, pose a serious problem to neo-liberal perspectives on the international trade regime. However, from an empirical point of view the neo-realists might also have a problem explaining the existence of a seemingly strong international trade regime such as the WTO insofar as propositions of hegemonic stability do not account for the political outcomes of trade liberalisation as suggested by Conybeare<sup>85</sup>.

### Relative or absolute gains: The neo-liberal / neo-realist debate

In many ways it has been the aim of the neo-liberals to show, that co-operation under conditions of anarchy is indeed possible without assuming the existence of altruistic actors or coercive hegemons. Not even assumptions of moral or norm driven behaviour are necessary for co-operation on common interests to exist between states in the international system.

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<sup>84</sup> Hasenclever, Mayer and Rittberger (1997) op. cit., p. 4.

<sup>85</sup> Conybeare (1984) op. cit.

Based on rational choice theory and game theory, neo-liberal scholars like Robert Keohane wanted to show that co-operation was not only possible but also likely even based on realist assumptions<sup>86</sup>. Even among the most egoistic and one-eyed, utility maximising actors order and co-operation could occur and indeed did occur. Thus starting from basic realist assumptions the neo-liberals thought to have proven that the establishment of international regimes (such as the international trade regime) was not dependent on hegemonic actors either supplying the public good themselves or enforcing co-operation to that same end.

However, the neo-realists are not so easily persuaded. Their objection is that the neo-liberals have left out the most important of realist assumptions – i.e. the importance of relative gains (and power struggles) as opposed to absolute individual gains. Amongst others Robert Gilpin<sup>87</sup> and Kenneth Waltz<sup>88</sup> have stressed the importance of relative gains in the political economy of international relations, and with special reference to the international trade regime Joseph M. Grieco<sup>89</sup> has asserted that the neo-liberals have in fact missed the basic points of realism.

The central claim of realism is not that anarchy causes states to be rational egoists and that the most important impediment to co-operation (i.e. the dilemma of collective action) is the risk of cheating. Rather, the most important claim of realism is that anarchy forces states to be “defensive positionals”<sup>90</sup>. Defensive positionalism means that states are not only worried about their own gains from co-operation they are also worried about the gains of other states. Under conditions of anarchy, states cannot afford to worry about individual utility maximising. Instead, securing their autonomy and survival is the most important goal since under conditions of anarchy the threat of violence or destruction is always imminent. The balance of power among nations plays an important role, and power is always relative.

Therefore, the gains from engaging in trade liberalisation must always be seen in terms of power. The distributive effects of trade are crucial for the willingness of any single state to remove trade barriers insofar as they will change the balance of power in favour of some and in disfavour of others. Therefore, the distributive effects of trade probably constitute the most fundamental obstacle to the establishment of an international trade regime and not the problem of uncertainty, the risk of cheating, or the problem of monitoring and ensuring compliance. In sum, from a neo-realist perspective, international co-operation in the field of trade (or in any other issue-area) entails all the difficulties envisioned by the neo-liberals plus the problem of unequal distribution of gains. Although individual fortune is definitely a good thing, the misfortune of others is not so bad either.

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<sup>86</sup> See Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World political Economy*.

Princeton University Press, Princeton 1984 and; Robert Axelrod and Robert O Keohane, “Achieving Cooperation under Anarchy: Strategies and Institutions”. *World Politics*. Vol 38, no. 1, 1986, pp. 226-252.

<sup>87</sup> Robert Gilpin, *The Political Economy of International Relations*. Princeton University Press, Princeton 1987.

<sup>88</sup> Kenneth N. Waltz, *Theory of International Politics*. MacGraw-Hill, New York 1979.

<sup>89</sup> Joseph M. Grieco, (1990) op. cit..

<sup>90</sup> Ibid. pp. 28-29 and pp.36-40.

This neo-realist emphasis on relative gains has been countered by the neo-liberals<sup>91</sup> arguing that although relative gains might be important and influence any individual country's perception of trade liberalisation they only do so at the margin. Relative gains are not always important or equally important at any stage of international trade negotiations. Relative gains may be more or less important at some stages of negotiations and in some issue-areas than in others.

I have mentioned above that negotiating trade agreements and establishing a trade regime is one thing. Managing the agreements is another. While in negotiating trade agreements states might be more inclined to disregard concerns for relative gains attempting to avoid Pareto-sub-optimal outcomes, the trade disputes that arise afterwards might very well look like struggles over relative gains. Thus negotiating agreements and managing agreements within the framework of an international regime are two different things, and in the words of Keohane: "States making a mutually advantageous bargain can be viewed as both moving up to the contract curve and moving along it to a single point. The first outward movement is beneficial to both sides; but any movement along the contract curve benefits one party at the expense of the other. It is incorrect to infer from the roughness of life on the Pareto frontier -- that "relative gains" are significant motivations for states. Struggles for distributional advantage could account for tough bargaining along the contract curve, as they do in ordinary market situations such as a sale of a house from one person to another"<sup>92</sup>. The neo-liberal conclusion made by Keohane is that although relative gains are sometimes important in deciding the distribution of the benefits from co-operation (e.g. on trade) they need not impede the establishment of an international regime in the first place.

The very existence of the WTO and the constant quarrels over especially non-tariff barriers to trade suggest that there is both a concern for collective interests and a rather stormy life on the Pareto frontier. Life on the Pareto frontier could among other things be expected to involve questions of compensation of losers (or even of the relatively less fortunate winners). E.g. WTO-agreements involving special treatment of least developed countries might be seen as an attempt to compensate potential losers. However, a general alleviation of the distributive effects of trade and of international capital mobility is rather doubtful since winners and losers (contrary to the predictions of classic Ricardian trade theory) are situated in different countries and not only in different industries within national borders. Therefore, as seen from the perspective of international trade theory, there ought to be as little life on the Pareto frontier as on Mars.

In the eyes of neo-realists, the emphasis on relative gains and the distributional effects of trade self-evidently presents a problem for the establishment of a free trade regime. However, the problem of international compensation might exist even for neo-liberals since there is no guarantee that even absolute individual gains will result from engaging in free trade. In other words one might ask; what is it that gives rise to regimes such as the WTO and thus sustains life on the Pareto

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<sup>91</sup> Keohane (1992,?)

<sup>92</sup> As cited from Wæver (1992) op. cit., p. 150. The phrase "roughness of life on the Pareto frontier" refers to the sub-title of the article by Krasner (1991) op. cit. (i.e. "Life on the Pareto Frontier"). Apparently, though, this does not induce Keohane to dismiss the PD as the major dilemma of collective action in favour of other dilemmas such as e.g. the "battle of the sexes". For a discussion of this see Hasenclever, Mayer and Rittberger (1997) op. cit., pp. 104 ff.



frontier when rational actions of states do not seem to provide the full answer? Suggestions might very well come from cognitive perspectives on international regimes.

### Cognitive / Reflectivist alternatives

When considering cognitive perspectives on international regimes we depart ourselves from assumptions of rationality of either the myopic individual nature represented by neo-liberals or the relative-gains version of the neo-realists. Maybe the explanation for the almost global celebration of the idea of free trade and the after all quite stable support of the international free trade regime is to be found in the perceived interests and in the ideological beliefs of actors rather than in their actual (rational) interests. Maybe both the establishment and management of the international trade regime is better explained by the social construction of interests within the framework of the WTO than by “exogeneously” given interests of member states suggested by classic Ricardian trade theory and the rational choice perspectives underlying main stream regime theories.

The establishment of the WTO could be seen as a case of “Symbol-Politik” (i.e. as a project propelled by ideology), while concrete trade disputes could be seen as cases of “Real-Politik” (i.e. politics propelled by rational interests). To the extent that the former is continued in the settlement of trade disputes so that collective interests are maintained and national interests are contained propositions concerning the importance of cognitive and institutional factors are strengthened.

The discussion of international trade theory above has suggested that it might be problematic to treat national interests in free trade (or more precisely in trade liberalisation) as exogeneously given. The logical consistency of both neo-liberal and neo-realist perspectives is questionable. First, there might not always be individual absolute gains involved at all in liberalising international trade (only global ones). From the point of view of single states, trade liberalisation looks more like a zero-sum game right from the beginning. In other words, there is no Pareto frontier to be reached. It is already reached. Second, although this seems to support the typical realist reservations towards the possibility of international co-operation in the field of international trade, the relative-gains argument seems superfluous. Remember the realist critique was that although everybody gains from trade liberalisation in absolute terms, the relative distribution of those gains would impede international co-operation on the removal of trade barriers. But, everybody doesn’t gain from trade liberalisation and strictly speaking, there is no absolute-gains argument to kill. (In other words, the zero-sum argument is more relevant than the relative gains argument).

However, rather more problematic to the neo-realist critique of regime theory is the empirical fact of international co-operation on trade liberalisation and the virtually global celebration of free trade as a desirable goal of both single countries and the international community. Both the results of the Uruguay Round and the establishment of the WTO indicate a strengthening of the international trade regime which calls for alternative explanations insofar as propositions of hegemonic stability / leadership or rational (utility maximising) action is not supported.

Maybe the widespread interest in trade liberalisation is rather socially constructed and maybe the WTO system itself plays an important role in defining these interests and in securing compliance and confining defection (protectionist action). In conclusion, there seems to be a gap to be filled in both interest-based and power-based regime theories in explaining the origins of interests in trade liberalisation as perceived by states.

Hasenclever, Mayer and Rittberger assert that some of the cognitive (or knowledge-based) regime theories seek to add a theory of preference formation to interest-based regime theories. These approaches may be seen as complementary to the rationalist neo-liberal main stream and are labelled “weak cognitivism”. However, there is also a more “strong cognitivist” criticism applying an even stronger sociologically informed institutionalism to the study of international regimes<sup>93</sup>.

The point is that institutionalised practices affect the identities of international actors, and that often states are better understood as role-players than as utility-maximisers<sup>94</sup>. Concerning the international trade regime this means that national interests in trade liberalisation are not necessarily given beforehand. Instead continued support for the trade regime and WTO agreements (in spite of defeats) is sustained during the process of negotiations, decision-making, and dispute settlement within the framework of the WTO system. Furthermore, this also suggests that the WTO might be able to manifest itself as an independent player by virtue of its organisational resources, bureaucratic staff, and trade experts. Thus from a cognitivist point of view the organisational strengthening of the GATT-agreements through the establishment of the WTO constitutes an important development of the international trade regime.

A cognitive regime perspective suggests that the decision-making processes and the “agenda setting” within the framework of the WTO-system should be subject to more detailed analysis instead of being “black boxed”. Both interest-based neo-liberal and power-based neo-realist perspectives tend to overlook the importance of institutional processes when explaining the political outcomes of international co-operation.

Cognitivists are not so easily compared to their neo-liberal and neo-realist counterparts based on what actors and issues they deem most important in international politics. The state – non-state actor dichotomy does not seem as relevant in this connection. Nor so does the security – non-security (economic) issues dichotomy. However, most cognitivists can reasonably be said to share at least some of the views of the neo-liberals. Both security issues and economic issues are important to state actors (or are perceived by state actors to be so). As for non-state actors cognitivist perspectives ascribe a maybe even more important role to international institutions than suggested by neo-liberal perspectives. International institutions and the political decision-making processes play a profound role in shaping the beliefs and interests of state actors. Institutions such as the WTO constitute much more than a framework for decision-making lowering the transaction costs of co-operation by reducing uncertainty and increasing transparency. They are more than intervening variables improving the conditions under which individual and collective interests can be realised (discovered) and pursued.

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<sup>93</sup> Ibid., p. 5 and pp.136 ff.

<sup>94</sup> Ibid. p.5.

(Interests that are still exogeneously given according to the neo-liberals). Note that cognitive variables such as knowledge is also important to the neo-liberals, but this doesn't change the fact that state actors are still rational utility maximisers or "satisfiers" as Herbert Simon would have it<sup>95</sup>. Regimes only move the boundaries of rationality and improve the conditions for utility satisficing, they do not define the nature of rationality itself. From a cognitive perspective, however, regimes affect the nature of rationality more directly.

Arguably international institutions such as the WTO can be seen as actors in their own right both setting the agenda for collective action and defining the collective interests of the international society and of individual state actors. The institutional and organisational resources of international regimes is a crucial variable determining the uncertainty reducing capacities of the regime and as such both neo-liberals and those cognitivists stressing the importance of "epistemic communities"<sup>96</sup> emphasise the importance of cognition or knowledge improving capacities of international regimes. However, the problem of uncertainty runs deeper in the eyes of cognitivists. Regimes do not only help reducing uncertainty about the behaviour, interests and intentions of other states. Often states and state actors (i.e. politicians) are not aware of their own interests or of the consequences of their actions. Therefore, scientists and experts can form epistemic communities providing information and shaping decision-makers perceptions of own interests. The WTO as an institution dominated by economists and international lawyers can also form epistemic communities with national bureaucracies surrounding the political decision-makers involved in trade negotiations. In this way policy networks linking national and international bureaucracies can influence the interests pursued by state actors, the definition and support of common goals, and the political outcomes of concrete disputes within the trade regime. Depending on the nature of such epistemic communities or policy networks the support of free trade as collective interest or a public good of the WTO member states can be smaller or greater than expected based on their actual rational interests. Perceived (or taught) national interests in free trade become more important than interests deduced from theory or inferred from empirical evidence.

Perhaps the difference between weak cognitivism and main stream neo-liberal regime theory is not that big after all as they share many of the same ontological assumptions about norms and rules and co-operation as a functional response to perceived collective interests<sup>97</sup>. But, the jump from a weak to a stronger cognitivism might not be so big either. Certainly the epistemic community perspective is also open to the idea that the support for free trade and the perceptions of trade as a collective interest is socially constructed and propelled by the ideological belief systems of economists and trade experts. The notion of international free trade as a benefit to all states (not only to the trading nations collectively) and thus

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<sup>95</sup> Herbert Simon, "A behavioral theory of rational choice". *Quarterly Journal of Economics*. 69, 1954, pp. 99-118.

<sup>96</sup> For a discussion of the epistemic community perspective see Peter M. Haas, "Epistemic Communities and the Dynamics of International Co-operation" in Volker Rittberger (ed.). *Regime Theory and International Relations*. Clarendon Press, Oxford 1995. See also Peter M. Haas, *Saving the Mediterranean: The Politics of International Environmental Cooperation*. Columbia University Press, New York 1990 and Peter M. Haas, "Introduction: Epistemic Communities and International Policy Coordination" in Peter M. Haas (ed.), "Knowledge, Power and International Policy Coordination". *International Organization* (special issue). Vol. 46, no. 1, 1992.

<sup>97</sup> Hansenclever, Mayer and Rittberger (1997) op. cit., pp. 154-55.

the broad support of the WTO-regime seems to be more based on ideology than on rational choice. A basic question of both weak and strong cognitive perspectives of international regimes is, from where do national interests and perceptions of collective interests originate thus sustaining life on the Pareto frontier?

Arguably rational choice based and cognitivist regime theories can be seen as two extremes of a continuum with an “objective” rationality based on reality at the one end and a “subjective” rationality based on the “social construction of reality” at the other<sup>98</sup>. When we move along the continuum from rational choice based perspectives on international regimes towards strong cognitivist perspectives, international co-operation becomes less dependent on a “logic of consequentiality” (e.g. what are the benefits of trade liberalisation?) and more dependent on “logic of appropriateness” (what is the right thing to do?)<sup>99</sup>.

A cognitive perspective on the international trade regime entails that the continued support of trade liberalisation and the political outcomes of concrete trade disputes cannot be explained based on the rational interests of and / or the distribution of power among the WTO members. Instead, the dynamics of the regime and the political outcome of disputes should be interpreted in the light of organisational decision-making processes within WTO institutions<sup>100</sup>, the policy networks and “epistemic communities” of national level and WTO level officials surrounding political decision makers<sup>101</sup>, and the ideological support of the propositions of classic trade theory<sup>102</sup>.

This of course also has implications for the way that analyses of concrete dispute settlements should be approached. Where is empirical evidence likely to be found and how are theoretical inferences made about the political outcomes of the disputes? Rational choice based theories suggest deductive reasoning whereas cognitive perspectives suggest more inductive and interpretive reasoning.

## Conclusions

Public goods have rather special properties, as has been shown in the discussion above and as opposed to private goods they cannot be provided on market terms. This in turn has been one of the central arguments for the existence of central authorities within the nation state. A central purpose of state authorities is to secure collective interests in infrastructure, military and legal security, clean environment and the like by means of taxes, legislation and the executive powers vested in them. There are no such powers or authorities within the international

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<sup>98</sup> A seminal discussion of the notion of reality as a social construction is Peter L. Berger and Thomas Luckmann, *The Social Construction of Reality*. Doubleday, New York 1966.

<sup>99</sup> March & Olsen (1989) op. cit.

<sup>100</sup> This is an institutional argument in the line of March & Olsen (1989) op. cit.

<sup>101</sup> This is an argument in the line of Haas (1990, 1992, 1995) op. cit.

<sup>102</sup> John G. Ikenberry emphasises the influence of a “new line” of (Keynesian) economic thinking on the Anglo-American settlement establishing the postwar international economic order. See John G. Ikenberry, “Creating Yesterday’s New World Order: Keynesian “New Thinking” and the Anglo-American Postwar Settlement” in Judith Goldstein & Robert O. Keohane, *Ideas and Foreign Policy: Beliefs, Institutions, and Political Change*. Cornell University Press, Ithaca 1993, pp. 57-86.

system of states, and therefore collective interests must be secured by some other mechanism such as international regimes. Within IR-theory and regime theory the alleged collective interests in free trade are also the central explanation for the existence of international agreements such as the GATT agreements and of international organisations such as the WTO. Altogether the GATT agreements and the WTO comprise an international trade regime enabling its members to co-operate and to co-ordinate behaviour under conditions of formal anarchy. However, as has been argued above, it is difficult to explain the existence of the WTO regime from the perspective of (neo-)classic trade theory (based on comparative advantages) and from the associated political economy perspectives (based on individual rational action of single states).

The proposition that comparative advantages serve as the basis for international trade rests on a number rather unrealistic conditions. Perhaps the most important condition is that only goods and not capital cross over national borders. Moreover, assumptions are made on perfect competition and constant returns to scale. Both the actual conditions of competition on international markets (motivating strategic trade policies) and international mobility of capital make the establishment of an international trade regime prone with conflicts. This is not only because of the dilemmas of collective action associated with trade liberalisation, but because a general and mutual removal of trade barriers is not necessarily an advantage of any single country (neither relatively nor absolutely).

This affects both the status of free trade as a public good and the conditions under which co-operation on the removal of trade barriers is likely to emerge. With the assumption that capital only moves within national borders there is in fact no incitement to protectionism<sup>103</sup>. There is no serious PD or free-rider dilemma and exactly as in the case of driving to the left or to the right there is no incitement to non-compliance with trade agreements. Thus, the dominant strategy will be to co-operate (i.e. to remove trade barriers). However, national distributive effects of free trade might change the strategy towards defection (i.e. protectionism) since national groupings (industries) might have a strong interest in maintaining trade barriers.

From a neo-realist perspective, the international distributive effects of free trade might have the same effects. In order to have real comparative advantages the other critical assumptions of trade theory mentioned by Constanza (e.g. internalisation of environmental costs) must, of course, also be fulfilled<sup>104</sup>. Equally, the gains associated with strategic trade policies might spur protectionism.

Regardless of how the benefits of trade are distributed among the trading countries the point is that everybody wins when trade is based on comparative advantages. There is not only a global (collective) benefit to trade but also an individual (national) one. As seen from the perspective of neo-liberal regime theory this is also the most important reason for the establishment of an international trade regime. The fact that the benefits of trade are not equally distributed is not in itself prohibitive to international co-operation on trade liberalisation as seen from a neo-liberal IR-perspective. From a realist perspective, however, it might indeed be

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<sup>103</sup> At least not in symmetrical 2-actor PD game. However, in a N-actor game big actors might have an incitement to introduce an internationally re-distributive tariff. Conybeare (1984) op. cit.

<sup>104</sup> Constanza (1997) op. cit.

so, but from a neo-liberal perspective (individually) rational actors will not abstain from co-operation just because of relative differences in the benefits of free trade. They will primarily be interested in absolute individual gains. However, if capital flows freely over borders even hard core individually rational liberals ought to question their faith in free trade (at least on theoretical grounds).

It is questionable if the establishment of an international free trade regime involves a dilemma of collective action in the form of a PD when trade is based on comparative advantages. This dilemma is central to the leading neo-liberal regime theories on the international trade regime. The discussion above suggests, on the one hand, that international co-operation on trade liberalisation might be more difficult than suggested by classic international trade theory and neo-liberal regime theory. On the other hand, neo-realist theories might not tell the whole story either. Although the relative gains argument does not depend on assumptions of either absolute gains or comparative advantages, trade liberalisation within the WTO-regime is in need of further explanation insofar as hegemonic stability arguments are not supported as suggested by Conybeare<sup>105</sup>.

The theoretical discussion above makes it possible to pose questions about the politics of the WTO-regime and to make propositions about the political outcomes of trade disputes. How is compliance with rules and support of the regime (in spite of clashes of interests) best explained? From a cognitive perspective propositions might stress the normative “compliance pull” associated with a co-operative international society<sup>106</sup>. This compliance pull can take the form of a normative “sense of obligation”, a sense of “we-ness”, a sense of “community”, or of a desire to be part of a morally superior international society of states (i.e. to be one of the “good guys”). However, it is not self-evident that concrete political outcomes of trade disputes should always put the free movement of goods over all other concerns such as the national (and international) interests in environmental regulation.

The new international trade regime has experienced a number of trade disputes in which environmental regulations of leading members of the regime (e.g. USA and EU) have come under pressure<sup>107</sup>. Insofar as these regulations have constituted non-tariff barriers to trade, they have been deemed to violate the trade agreements of the regime and to serve protectionist rather than environmental purposes. In almost all of the disputes settled within the dispute settlement system of the WTO environmental concerns have been defeated by free trade concerns. This has been the case regardless of whether the regulations in question have been aimed at strictly national environmental matters or at international or global matters. It

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<sup>105</sup> Conybeare (1984) op. cit.

<sup>106</sup> The notion of “community” or “society” midst anarchy in international politics is often associated with the “English school” IR-theory as represented by e.g. Herbert Butterfield & Martin Wight (eds.), *Diplomatic Investigations: Essays in the Theory of International Politics*. London 1966 and Bull (1977) op. cit. As such this sense of community in international politics also entails a “pull” to comply with shared norms or agreements.

<sup>107</sup> Examples are the famous “Tuna-Dolphin dispute” (Settled under the previous GATT regime); the “Gasoline dispute” (WT/DS2, WT/DS4); the “Shrimp-Turtle dispute” (WT/DS26, WT/DS48); and the “Hormones dispute” (WT/DS58). The alleged environmentalist purposes of the trade restrictions, which have the subject of these trade disputes have all been rejected by the WTO. (The numbers in parenthesis refer to the official identification numbers of the reports of the WTO dispute Settlement Body (DSB). The reports can be retrieved at the WTO internet homepage at <http://www.wto.org/>

seems that free trade concerns are systematically favoured over environmental concerns and that national environmental regulations are seldom tolerated if they affect the free movement of goods negatively.

Accordingly, one might ask the question; why have “free trader perspectives” been in such a strong position as compared to “environmentalist perspectives” when trade-environment disputes have been settled within the WTO dispute settlement system? (Even when the latter have been defended by supposedly strong members of the regime against weaker members). Lacking rational and theoretical reasons for the unconditional celebration of free trade (including the notion that free trade concerns and environmental protection are complementary rather than contradictory) other explanations for the political outcome of trade-environment disputes are needed.

It seems, on the one hand, that particularly the USA and EU (or the rich and developed western countries in general) have supported a far reaching agenda for removal of trade barriers. On the other hand, they have backed down from this agenda implementing various kinds of environmental regulations impeding the free movement of goods. They seem to support the idea of free trade and the WTO-agreements designed to implement it, but they are apparently unwilling to accept restrictions on their right to implement environmental regulations. If they are not exactly unwilling to accept restrictions on national environmental regulation at least they have in a number of cases proven unable to defend their alleged interests in national environmental regulations.

A two-fold proposition explaining this seeming policy paradox of leading members of the WTO might be suggested. First, disputes and defeats should be seen in the light of domestic policy processes forcing political decision-makers of leading members (e.g. USA and EU) to implement certain environmental regulations, and in turn defend these against the demands of deregulation and removal of trade barriers in the WTO<sup>108</sup>. Second, both the domestic political processes shaping the foreign policies employed by member states in trade negotiations and the political processes within the WTO-system itself have favoured free trade perspectives at the expense of environmentalist perspectives leaving little room for national environmental regulations with negative effects on free trade. Economists have occupied the central executive positions and dominated the central decision-making procedures of both domestic and regime levels of decision-making. An epistemic community favouring free trade perspectives has dominated the political processes of the trade regime.

Especially the latter of these propositions are less dependent on either neo-liberal or neo-realist assumptions of rational choice. Instead, they are more open to interpretive explanations stressing ideological and social constructivist explanations for the dominance of free trader perspectives in spite of conflicting interests of member states in national environmental regulations.

In many ways the central question of this analysis is not only why WTO members support the WTO regime, and more or less willingly (if not happily) comply with GATT regulations even though they do not strictly speaking fit their individual

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<sup>108</sup> This is more or less in line with the domestic level factors of Putnam’s “two-level game” analysis. Putnam (1988) op. cit.

national interest. (That is they have no interest in complying in the absence of hegemonic leaders or other mechanisms of applying selective incentives). The question is equally (and maybe more importantly) how the international trade regime has produced political outcomes so consistently favouring free trade concerns in the settlement of trade-environment disputes.



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